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IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

ESTATE OF HELEN H. LADEWIG, on behalf of itself and the class of all persons in the State of Arizona who, during any one of the years 1986 to 1989 paid income taxes to the State of Arizona on dividends paid by corporations whose principal business was not attributable to Arizona, et al., Plaintiffs, vs. ARIZONA DEPARTMENT OF REVENUE and its Director, in his official capacity, Defendants.	**No. TX 97-00075** **PLAINTIFFS' COMBINED MOTION FOR AN ORDER DETERMINING THE DEPARTMENT'S LACK OF STANDING TO CONTEST CLASS COUNSEL'S COMMON FUND ATTORNEYS' FEE AWARD** **-AND -** **MOTION IN LIMINE** (Assigned to the Honorable Paul A. Katz)

Plaintiffs, by and through their counsel undersigned ("Class Counsel"), hereby move this Court for an Order ruling that the Department of Revenue (the "Department") has no standing to contest Class Counsel's common fund attorneys' fee award, and further precluding the Department and its counsel from offering evidence or otherwise participating in the hearing on Class Counsel's Motion for a Common Fund Fee Attorneys' Award set for December 16, 2002.

After doing everything in its power to deny class members refunds for nearly 12 years, the

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Department now seeks to justify its interference in a fee award it is not paying by claiming this Court will "need" the Department's input to ensure the "reasonableness" of the award thereby protecting the class members from their own attorneys who made the refunds possible. *See* Department's "Motion to Set Deadline to Substantiate Attorneys' Fee Request" (the "Motion"), at p. 3. In the words of the former Chief Justice of the Arizona Supreme Court, Thomas Zlaket, the Department's asserted "justification" is "ludicrous." Another highly respected expert in this field, Professor Charles Silver, considers it "laughable." In any event, the Department is precluded from contesting Class Counsel's fee award for at least four separate reasons, any one of which is dispositive.

First, the Department agreed in the Stipulation of Settlement (the "Settlement") that Class counsel is entitled to a reasonable fee. The Director of the Department has publicly admitted the fee requested by Class Counsel is in fact "**fair.**" Thus, there is no longer any potential factual basis for the Department to be heard, even if Arizona law afforded it standing, which it does not. Arizona law precludes either a party or an attorney from challenging a fact that has already been conceded, and the Department and its counsel's insistence on interfering after its own Director has admitted the requested award is "**fair**" reveals the Department's real motive here — to drive the fee award as low as possible by any means possible.

Second, less than two years ago the Arizona Court of Appeals considered the Department's standing argument in another tax refund case, *Kerr v. Killian*, 197 Ariz. 213, 3 P.3d 1133 (App. 2000) (*Kerr III*), and, like the majority of other courts that have considered the question, squarely rejected it. Review was denied by our Supreme Court on December 5, 2000. Thus, both Arizona law and principles of collateral estoppel flatly preclude the Department's claim of standing here.

Third, the Department's attempt to interfere in the relationship between Class Counsel and their clients is ethically improper. As Mr. Zlaket explains in his Report, which is attached hereto as Exhibit "A," it would not be ethically proper for the Department's attorneys to participate in the process of awarding fees under the circumstances of this case. Furthermore, the Attorney

General, who represents the Department, cannot now purport to also represent the taxpayers' interests even if her client had standing, which it does not. Stated another way, even if the Department could somehow suddenly change hats and assume the role of the "protector" of the class, its lawyers, the Attorney General's Office, cannot represent two clients whose interests are in direct conflict.

Fourth, as Professor Charles Silver, a nationally-renowned expert on class actions and due process, explains in his Declaration (attached hereto as Exhibit "B"), the Department's interference in the relationship between Class Counsel and the class members is designed to create conflicts that are simply not permitted under the Supreme Court's current pronouncements on due process and class actions. In fact, allowing the Department to interfere here, after a class has been certified, a settlement preliminarily approved and notice already sent would violate the due process rights of the absent class members and would call the entire validity of the Settlement into serious question.

For all of these reasons, this Court should rule the Department has no standing to be heard on Class Counsel's Motion for a Common Fund Attorneys' Fee Award and should preclude the Department and its counsel from offering evidence or argument at the hearing on that Motion set for December 16, 2002. This Combined Motion is supported by the following Memorandum of Points and Authorities, the exhibits thereto (including the Declaration of Randall D. Wilkins, attached hereto as Exhibit "C") and by the Court's entire file herein.

RESPECTFULLY SUBMITTED this 31st day of October, 2002.

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By: Randall D. Wilkins

Paul V. Bonn, Esq.
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MEMORANDUM OF POINTS AND AUTHORITIES

I. THE DEPARTMENT AND ITS DIRECTOR HAVE ADMITTED THAT CLASS COUNSEL'S FEE REQUEST IS FAIR, AND THUS NEITHER THE DEPARTMENT NOR ITS ATTORNEYS CAN CONTEST THE ISSUE FURTHER, WHETHER THE DEPARTMENT HAS STANDING OR NOT.

A critical development occurred in this case which now avoids the necessity of addressing the Department's assertion of standing. At the last status hearing, the parties and the Court discussed the resolution of the Department's Motion, which seeks to impose a host of improper discovery duties and related deadlines upon Class Counsel. However, the evening before that hearing the Director of the Department, Mark Killian, who is also a party in this case, appeared on KAET Television's "Horizon" program to discuss this case. During the course of his interview, Mr. Killian unequivocally admitted the amount sought by Class Counsel, 12%, was "**fair**:"

Moderator:	$30 to $40 million in attorneys' fees. Do I understand this correctly?
Killian:	That's correct.
Moderator:	Is that under advisement by the judge?
Killian:	**The mediator between the state and the plaintiff's attorneys has made a recommendation of not more than 12% on the attorneys fees. And that's something that the judge will have to decide whether he wants to accept. In other types of cases, class action lawsuits, you've seen payouts being as high as 33%. So from a fiduciary standpoint, we think 12% is fair, but we're going to leave it up to the judge to decide whether he wants to lower that or not.**
Moderator:	Because that sum, whatever that sum may be, is deducted actually from the corpus of the refund amount, roughly $350 million?
Killian:	That's correct. The administration and the legal fees come out of that $350 million.

A true and correct copy of the program transcript, downloaded from KAET's website, is attached hereto as Exhibit "C-4." A true and correct videotape copy of the program is also enclosed with the Court's copy (only) as Exhibit "C-5" for the Court's review.

Upon confirming the Department's binding admission, Class Counsel made demand on

both the Department and the Attorney General that they cease any further efforts to interfere with the fee request, pointing out Arizona law absolutely precludes an attorney from denying a claim that has already been conceded. *See, e.g., James, Cooke & Hobson, Inc. v. Lake Havasu Plumbing & Fire Protection*, 177 Ariz. 316, 868 P.2d 329, 334 (1993) (attorney violates Rule 11 by denying a claim without a valid reason.) A true and correct copy of Class Counsel's demand letter of October 16, 2002, is attached hereto as Exhibit "C-6." On October 17, 2002, the Department's attorneys responded, refusing to drop their interference despite their client's binding admission, in violation of their duties to this Court and their profession. A true and correct copy of the response letter is attached hereto as Exhibit "C-7." **Significantly, the response did not dispute the Director's admission nor seek to qualify it.**[1]

As a result of this party admission, which is binding on both named Defendants (for example, Mr. Killian is the official who signed the Stipulation of Settlement on behalf of the Department), it is now readily apparent there is no longer even a colorable reason for the Department to further contest Class Counsel's fee request, even if the Department had standing, which it plainly does not. As the Director put it, Class Counsel's request for a fee award equal to 12% of the common fund they created is "**fair**." To the extent the Department continues to seek to be heard here, it simply confirms the fact that the Department (or its attorneys) are pursuing an improper ulterior motive, which is ethically improper and must not be allowed.

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[1]The Attorney General's conduct in this case is especially troublesome given the Attorney General's position in prior cases where it was entitled to a common fund fee award. For example, Class Counsel confirmed with lead counsel in the *Petroleum* antitrust case, a common fund case in which the Arizona Attorney General participated as co-class counsel, *see In Re Coordinated Pretrial Proceedings in Petroleum Products Antitrust Litigation*, 1994 WL 675265 (D. Cal. 1994), that one of the terms of the settlement insisted upon by class counsel was the condition that the defendants could **not** be heard on the fee request. Given that the Attorney General has both recognized and insisted upon adherence to the general rule that the losing party in a common fund case cannot interject itself into the fee award between the class and their counsel in cases in which it was involved, the Attorney General's position here appears to be in bad faith. Moreover, the percentage requested here, 12%, is less than the fee the Attorney General has been paid in cases of a similar magnitude and it is also less than the fee the State has agreed to pay when it hires private lawyers on a contingency fee basis, which further underscores the bad faith. *See* Silver Declaration, ¶ 22.

II. THE DEPARTMENT HAS NO COGNIZABLE INTEREST IN THE FEE AWARD IN THIS CASE.

The Department's assertion of standing and its alleged "concern" for the class members must be viewed in the context of this unique case, and not in the abstract. The relevant facts cannot be disputed:

Under the Settlement currently before the Court for final approval, Class Counsel's attorneys' fees are being paid by the 650,000 members of the class, out of the refunds they receive. **The Department is not paying even a penny of the fees it seeks to challenge.** The fees are being spread among the beneficiaries of the common fund. Moreover, the Department does not have any reversionary interest in the common fund; refunds are being paid and the money belongs solely to the class members. The Settlement also requires Class Counsel to represent the class members against the Department during the four years the refunds are being paid, during which time disputes between the class members and the Department will arise and their interests will continue to conflict. Thus, the Department has a vested interest in driving the award as low as possible in order to discourage Class Counsel's representation in those disputes.

Under these facts, the Department simply has no standing to contest Class Counsel's fee request. Unlike the situation where fees are being shifted to the losing party, and the substantive and procedural law discussed in cases such as *Schweiger v. China Doll Rest., Inc.*, 138 Ariz. 183, 673 P.2d 927, 932 (App. 1983) and *Associated Indem. Corp. v. Warner*, 143 Ariz. 567, 694 P.2d 1181 (1985) becomes relevant, this case is more appropriately analyzed as a contingency fee case, where the defendant has no say in the fee. The United States Supreme Court has expressly ruled that in cases such as the one before this Court, a losing defendant has no "cognizable interest" in the fee paid by the prevailing plaintiff to his or her attorney. *See Boeing Co. v. Van Gemert*, 444 U.S. 472, 482, fn. 7 (1980), where the Supreme Court explained the rule applicable here:

> **The judgment on the merits stripped Boeing of any present interest in the fund. Thus, Boeing had no cognizable interest in further litigation between the class and its lawyers over the amount of the fees ultimately awarded from money belonging to the class.** (Emphasis added)

Although *Boeing* and *Kerr III* are directly on point and flatly preclude the Department from contesting a fee award in which it has no cognizable interest, the Department once again asserts standing. This interference is particularly indefensible here, where in order to avoid the Department's ability to appeal the fee award, and thereby control Class Counsel's independence during the critical Settlement administration period, the parties have already presented their fee dispute to a highly regarded neutral expert selected by the Department, Bruce Meyerson. After considering extensive written submissions by the parties and oral argument, and after conducting his own independent investigation, Mr. Meyerson concluded the proper range for a fee award in this case was between 9% and 12 % of the common fund.[2] The Department has agreed it will not appeal the Court's fee award if it does not exceed 12%, and Class Counsel have limited their request to that percentage. At the preliminary Settlement approval hearing, this Court announced it would consider Mr. Meyerson's Report to be a special master's report under Rule 53, *Ariz.R.Civ.P.*

Unfortunately, despite Mr. Meyerson's recommendations, the Department is still attempting to interfere, seeking to further reduce the fee award (although it has now conceded it is not arguing for an award lower than 9%) by urging the Court to employ a method of awarding fees that has been discredited everywhere, does not work given the unique facts of this case, and which even the State does not use when it hires private attorneys to pursue substantial claims. *See* Silver Declaration, ¶ 22. The only explanation the Department has ever offered to justify its extraordinary interference here (where, unlike the situation in *Kerr III*, it isn't even paying a single penny of the fees), is an alleged concern that this Court cannot determine the reasonableness of the fee award without the Department's "input." Motion, at p. 3. However, even if the Department's concern were true, such a 'concern' is not a matter that legitimately involves the Department.

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[2]Although Mr. Meyerson did not take Class Counsel's future time and expenses into account in setting his range, he did recognize the significant amount of additional time and expense that will be required of Class Counsel during the four year Settlement administration, which irrefutably confirmed for him the reasonableness of the range he recommended.

As the Court is well aware, it sits as a fiduciary for the class on this issue. *See* Report of the Third Circuit Task Force, *Court Awarded Attorneys' Fees*, 108 F.R.D. 237 (1985). Class Counsel is confident that this Court, with its years of experience, is more than capable of arriving at a fair fee. It already has the benefit of a special master's report prepared by an experienced and well-respected expert to assist it. Why then would the Court need (or even want) to hear from Class Counsel's bitter opponent for the last 12 years — an opponent who has a vested interest in keeping the award as low as possible? Indeed, as Mr. Zlaket explains in his Report, it would be improper for the Court to do so under these facts.

Given the Department's unceasing efforts over the last 12 years to deny these taxpayers any refund at all, Class Counsel believes the Department's alleged 'concern' for the class members conceals a far more malignant motive— it seeks to curtail Class Counsel's ability to represent those class members in future disputes against the Department. Specifically, although the Settlement was skillfully designed by Class Counsel to limit future disputes, disputes are inevitable. For example, during the course of this litigation, the Department allowed public tax records to deteriorate to the point where they can no longer be read by the Department's computers. Although Class Counsel put the Department in touch with the leading forensic computer experts in the country, who can restore the degraded public records that will now be used to calculate the refunds, the Department knows there will be disputes, and Class Counsel is required to represent the class members in those disputes. By insisting that the Court award fees based solely upon Class Counsel's hours to date — **20 months before the Department knows how much will actually be refunded, and four years before Class Counsel's services and expenses are completed and known** — DOR obviously seeks to drive the fee award down as far as possible in order to disincentivize Class Counsel from vigorously contesting the Department's future conduct.

Alternatively, the Department's actual goal here may be to punish Class Counsel for bringing this case and thereby sending a message to anyone else who may think about challenging the Department in the future. In any event, the Department would never admit to

an improper ulterior motive, and the Court is left only with the Department's purported (and new found) "concern" for the class members — that they will somehow be 'abused' if the award is 12% as compared to 9% — as the basis for the Department's interference.

However, even this alleged 'concern' — assuming, *arguendo*, that it was ever anything but a fig leaf to conceal the Department's real goals —is no longer defensible because the Department has publicly admitted that 12% is in fact "**fair**." Thus, even under the Department's view of standing — which Class Counsel vigorously disputes — the Department has no "cognizable interest in further litigation between the class and its lawyers over the amount of the fees" and cannot further interfere here. *Boeing*, *supra*, 444 U.S. at 482, fn. 7.

III. THE DEPARTMENT HAS NO STANDING TO CONTEST THE FEE AWARD HERE UNDER THE ARIZONA COURT OF APPEALS' RULING IN *KERR III*, WHICH CONTROLS.

The Department's standing to challenge a fee award that it is not paying was conclusively decided against the Department two years ago in *Kerr III*. The Department is therefore precluded from challenging the fee award both as a matter of Arizona law and under the doctrine of collateral estoppel. In fact, the case against granting the Department standing here is even more compelling than it was in *Kerr III*, given the important procedural differences between the two cases. *See* §IV *infra*. Some additional *Kerr III* background is necessary because the Department has already signaled its intention to misstate both the facts and holdings of *Kerr III*, confusing the Court of Appeal's ruling on "aggrievement" with its ruling on "standing" in order to attempt to fabricate a standing claim here.

In *Kerr III*, the named-plaintiffs engaged in a nine year challenge of Arizona's discriminatory tax on federal employees' mandatory retirement contributions. Although class certification was sought, it was not maintained. In 1997, the plaintiffs and their counsel achieved a favorable decision before the Arizona Board of Tax Appeals for four of the tax years then at issue. The Department thereafter conceded the tax was illegal and began to pay refunds to some of the other taxpayers who had filed timely individual claims. Plaintiffs' counsel sought an award of fees pursuant to the common fund doctrine. Brushing aside a host of Department

objections, Judge Cates held the common fund doctrine applied in tax cases, enjoined the Department from mailing further refunds, and set a hearing to determine the amount of the fee award. *See* 191 Ariz. 293, 955 P.2d 49 (Tax 1998).

Judge Sylvan Brown thereafter presided over the hearing and awarded plaintiffs' counsel 20% of the common fund. Judge Brown directed the Department to withhold 20% of the refunds it was paying and to separately account to plaintiffs' counsel for those funds as well as 20% of the 26 refunds the Department paid before Judge Cates issued his injunction. Although Judge Brown did not yet have the guidance of the Court of Appeals' decision in *Kerr III*, he knew something was amiss with the Department's standing, commenting:

> Mr. Irvine, before you begin, I do have a question, and let me preface it with the fact that I am going to listen to you and I'm going to permit you to cross-examine, but I'm interested in what standing the attorney general has to appear and apparently represent the people that you fought for eight years to keep from getting any refunds and now represent them in saying that they shouldn't have to pay any attorney's fees for the refunds that they got . . . But you fought the taxpayers of Arizona for eight years to keep them from getting any money . . . Where do you get standing now to represent them in saying that they should get the money you refused to give them which you could have given them back in 1990 very simply without any trouble, couldn't you?

See excerpts of Transcript of Proceedings, pp. 16-18, Exhibit "C-1" hereto.

The Department appealed Judge Brown's 20 % award, contending, *inter alia*, the common fund doctrine did not apply in tax cases, the fee award was excessive, the Court erred by basing the award on a percentage of the fund instead of counsel's hours, and that the notice procedure used violated the taxpayers' due process rights. The Department argued the common fund doctrine did not apply because the action was never class certified and there was no notice to the taxpayers that they may have to pay fees to counsel they had not hired and who, in the Department's view, had done nothing to benefit the taxpayers (unlike this case, the Department denied there was a causal connection between the litigation and the decision to pay refunds).

Plaintiffs' counsel challenged the Department's right to appeal, arguing first, that it was not aggrieved by the judgment and second, even if the Department could appeal, that it had no standing to assert the taxpayers' due process rights (aggrievement is jurisdictional; standing is

not). The Department claimed it was aggrieved because it had to pay the fees on 26 of the refunds and had to account for the balance. Citing cases from one or two jurisdictions that have afforded government defendants standing to contest fees where their agency's interests were involved, the Department further claimed it had standing to assert other objections on behalf of the taxpayers.[3]

Although the Court of Appeals found the Department was **aggrieved** by the judgment, it held the Department **did not have standing** to assert the due process rights of the taxpayers to avoid the award. The Court first explained the basis for the Department's aggrievement:

> We believe that the Department has carried its burden of demonstrating that it is aggrieved by the judgment. First, there is the matter of having to pay 20% of 26 refunds out of the Department's own funds. Then, as the Department pointed out in its response to the motion to dismiss, the judgment required it to undertake multiple mailings that cost between $10,000 and $15,000 more than it would have otherwise had to pay. Finally, the Department must undertake the administrative task of withholding part of each refund and periodically accounting for and remitting the amounts withheld to the taxpayer's counsel.

3 P.3d at 216, 217. However, the fact the Department was aggrieved did not give the Department standing to raise arguments on behalf of the taxpayers, which is precisely what it seeks to do here.

The Court began its analysis of the standing issue by noting that under Arizona law, a litigant can only assert the due process rights of a third party if three conditions are satisfied. The Court concluded the Department could not establish any of the three conditions, given its nine-year adversarial relationship to the non-party taxpayers:

"THE DEPARTMENT DOES NOT HAVE STANDING TO ASSERT THE DUE PROCESS RIGHTS OF THE NON-PARTY TAXPAYERS

> The Department challenges the award on the theory that the procedure used to arrive at the award violated the process of law due non-party taxpayers because those taxpayers did not receive adequate notice that a common fund award would be sought. **The Department lacks standing to seek reversal on the basis**

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[3]True and correct copies of the pages from DOR's Reply Brief filed in *Kerr III*, in which the Department set forth its standing argument, are attached hereto as Exhibit "C-3."

> **of this argument because the right to due process asserted does not belong to the Department.** As we noted in *State v. B Bar Enterprises, Inc.*, 133 Ariz. at 101 n. 2, 649 P.2d at 980 n. 2, a litigant may be accorded standing to assert the constitutional rights of a third person only if the litigant has a substantial relationship to the third person, the third person is unable to assert the constitutional rights on his or her own behalf, and failing to grant the litigant standing would dilute the third person's constitutional rights. None of these requirements is met here. **The Department's attempt to assume a protective role as to non-party taxpayers can hardly be characterized as the manifestation of a substantial relationship in view of the Department's unceasing efforts over the last nine years to deny these taxpayers any refunds at all.** Moreover, the non-party taxpayers were able to assert their own rights. After the tax court ruled that the common fund rule applied, it ordered that notice of the hearing to determine the percentage of fees to be awarded be given to all of the taxpayers entitled to a refund. This was done. (emphasis in text added; emphasis in heading in original)"

3 P.3d at 1137. The Court of Appeals affirmed the twenty percent fee award, concluding: "This case, which involved nine years of unrelenting opposition on the part of the Department, reflects the exceptional circumstances that support the award." *Id.*, at p. 1140.

The Court of Appeal's ruling in *Kerr III* on the standing issue is consistent with the majority rule. *See e.g., Boeing v. Van Gemert, supra*, 444 U.S. at 482, fn 7; *Schmidt v. Apple Valley Health Care Ctr., Inc.*, 460 N.W.2d 349, 354 (Minn. App. 1990); *Niles v. City of San Rafael*, 42 Cal. App. 3d 230 (App. 1974); *Copeland v. Marshall*, 641 F.2d 880, 905 (D.C. Cir. 1980); *Sampson v. Eastman Kodak Co.*, 552 N.E.2d 1194 (Ill. App. 1990). *See also* Report of the Third Circuit Task Force, *Court Awarded Attorney Fees,* 108 F.R.D. 237, 255 (1985); 1 Conte, *Attorney Fee Awards*, § 2.27, p. 97 (2nd Ed. 1993).

A similar standing argument was made and rejected in the *Bailey* tax refund class action case in North Carolina, a case the Department has frequently cited to support its various positions on fees. In fact, *Bailey v. State*, 540 S.E 2d 313 (N.C. 2000), is particularly helpful because the court in that case was confronted with the very tactics the Department is employing here.[4] The reasoning of the North Carolina Supreme Court is also consistent with *Kerr III* and

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[4]This is not surprising because the Department's counsel appear to have been in close contact with the North Carolina Attorney General, and are essentially making the same arguments here that were rejected by North Carolina's courts. Class Counsel in this case was a fairness expert in the *Bailey* case and has noted in both the mediation proceeding and the Motion that the Department's arguments bear a striking similarity to the arguments

the majority rule.

In *Bailey,* after a settlement was reached between the State of North Carolina and the plaintiff class under which class counsel's attorneys' fees were being paid by the class members, out of their refunds (as is the case here), and the state further agreed it would not involve itself in the fee award, the North Carolina Attorney General contested the fee award anyway. Like here, the North Carolina Attorney General began his assault on the taxpayers' attorneys' fee request by filing a motion demanding access to their billing records. Although the plaintiffs moved to exclude the Attorney General from participating in the determination of the fee award, the trial court never ruled on the motion and simply awarded fees using the percentage method. The Attorney General thereafter appealed, making the identical standing arguments the Department now asserts here:

> By way of establishing standing as a proper party to pursue his substantive claims, the Attorney General seeks to downplay his ten-year tenure as counsel for defendants in favor of gaining recognition for his self-ascribed, common law role as "defender of the public interest." According to the Attorney General, Class Counsel have an inherent conflict of interest with their own class members when it comes to the matter of their fees. Therefore, in order to ensure that the attorneys are not financially advantaged to the class members' detriment, the Attorney General advocates that his office be viewed as both overseer and protectorate, and justifies his intervention thusly: (1) because the attorneys' fees awarded are excessive and because such excessive fees are not in the public interest, the Attorney General, as defender of the public interest, is obligated to act; (2) moreover, because he served as counsel for defendants throughout this case's long history, the Attorney General is uniquely qualified to so act.

540 S.E. 2d at 319.

The North Carolina Supreme Court did not accept either purported justification as a basis for standing. The Court began its analysis of the standing question by first noting the incongruous position the Attorney General had adopted in order to challenge the fee award (the same position the Department is in here):

> From the outset, we note that the Attorney General represented the State and its various agencies as defendants throughout this case's lengthy litigation, a position that placed his office squarely at odds with plaintiffs' interests for nearly a decade. Nevertheless, the Attorney General now contends that he has changed

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unsuccessfully advanced by the North Carolina Attorney General in *Bailey*.

> hats--eschewing his former clients in order to champion the cause of his long-term adversaries--because his self-described role as "defender of the public interest" allows, if not compels, him to do so. In short, the Attorney General argues that the amount awarded as fees to Class Counsel is excessive and concludes that since none of the prevailing class members have appealed the allocation of such fees, his office must carry the mantle--in the public interest.

540 S.E. 2d at 318. The court disagreed, concluding the Attorney General's appeal was "improper":

> From these facts, it is readily apparent that: (1) the State, as defendant, expressly agreed that it would not involve itself in the issue of plaintiffs' attorneys' fees; and (2) plaintiffs, none of whom appealed, were paying their attorneys not with State funds but with their own money. Thus, the Attorney General's client--the State as defendant--is without interest in either the allocation of attorneys' fees or the funds that paid them.

540 S.E. 2d at 319.

The tactics the Department is employing here should fare no better than they did in the state in which they originated —or put another way — Arizona's citizens should receive at least the same level of protection from their courts that was afforded to North Carolina's taxpayers by North Carolina's courts. Indeed, *Kerr III*, decided at the same time as *Bailey*, compels such a result. The Department has no standing to be heard at the fee hearing.

IV. THE CASE FOR DENYING THE DEPARTMENT STANDING HERE IS MORE COMPELLING THAN IT WAS IN *KERR III*.

Kerr III is dispositive, and precludes the Department from interfering further. In fact, the argument against the Department's standing in this case, after nearly 12 years of "unceasing opposition," is far stronger than it was in *Kerr III* for several reasons.

First, there is no issue of "aggrievement" present. Unlike *Kerr III*, where the Department was actually paying some of the fees itself, the Department is not liable for any portion of the attorneys' fees requested here. Moreover, any administrative duties imposed upon the Department relating to the attorneys' fees have been assumed voluntarily, pursuant to the Settlement. Indeed, the Department is being paid for all of its administration costs by the class members, out of their refunds! Any assertion of "aggrievement" under these facts would be frivolous. More importantly, it would also constitute a breach of the Settlement Agreement.

Second, unlike the situation in *Kerr III*, the only people actually paying the fees here will all be class members who have chosen to remain in the case, with Class Counsel as their attorneys, fully aware of Class Counsel's fee request. An express attorney/client relationship exists between the class members and Class Counsel that was simply not present in *Kerr III*. Thus, not only is there is no basis for the Department to meddle here, but allowing it to do so under these facts would constitute improper interference with the attorney/client relationship and, as Mr. Zlaket explains, a violation of Arizona's ethical rules. *See* §V *infra*.

Third, unlike *Kerr III*, the Department has already conceded the fee request sought by Class Counsel is "**fair.**" Moreover, the percentage has already been approved by a respected independent expert of the Department's choosing, Bruce Meyerson, who has looked at the matter extensively and already fully considered the Department's objections in his special master's report. The alleged "concern" that purportedly "justifies" the Department's involvement here — the reasonableness of the award — has been allayed.

Fourth, there is a critical distinction between the two cases that absolutely precludes the Department's interference: the future services Class Counsel will be required to perform over the four year Settlement period while the class members and the Department remain adverse. In *Kerr III*, given the denial of class certification, the fee award was solely limited to past services successfully rendered to that point of the litigation. Here, in contrast, Class Counsel will be required to represent the class members in their disputes with the Department for four years. How can the Department possibly be on both sides of those disputes? How can the Department now claim to be helping the very people it has been adverse to for 12 years and will remain adverse to for four more? It cannot. But, even if the Court were to stretch logic beyond credulity and allow the Department to be on both sides, the Department's attorneys cannot. The attorneys in the Attorney General's office are absolutely precluded from interfering with their opponent's relationship with their counsel, and are also precluded under our ethical rules from representing two parties whose interests conflict, as former Chief Justice Zlaket explains in his Report. *See* §V *infra*. Thus, even if the Department is granted standing, its counsel cannot be

heard under any circumstances.

Fifth, and finally, unlike the situation in *Kerr III*, where the Department's standing argument —that it had standing because of its alleged governmental interest in protecting its citizens from excessive fees or costs —was a matter of first impression, the Department has offered no new legal justification for its standing here, after *Kerr III* squarely decided this issue against the Department. Instead, like the North Carolina Attorney General in *Bailey*, the Department's recent Motion attempts to finesse the issue by suggesting its presence here is allegedly required because ". . . this court would need the Department's input into the reasonableness of the time expended by class counsel as it is the Department and their counsel who would have insight into the reasonableness of time expended over the last twelve years.. .." Motion, at p. 3. However, this purported "justification" (which is no longer necessary given Director Killian's binding admission that the award is "**fair**," and which is also factually false) puts the proverbial cart before the horse.[5] The Department's "input" is only proper if it has standing, which it plainly does not, under the rulings in *Boeing, Kerr III* and prior Arizona cases. Absent standing, the Department is merely an "officious intermeddler" whose "input" is not appropriate. *See Western Coach Corporation v. Roscoe*, 133 Ariz. 147, 154 650 P.2d 449 (1982) ("officiousness means interference in the affairs of others not justified by the

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[5]Furthermore, not only is the assertion incorrect as a legal principle, but is also based upon a false factual predicate: namely, that the Department's counsel have some special knowledge and expertise the Court "needs" but can only obtain from them. In point of fact, there is no attorney currently at the Attorney General's Office who worked on this case when this litigation commenced in 1991. One of the two attorneys who initially handled the case, Gail Boyd, left the Attorney General's Office long ago. The attorneys who wrote and filed the *Amicus Curaie* briefs in the key United States Supreme Court cases that Class Counsel also appeared in during the 1990's are gone as well. The one Assistant Attorney General who was involved throughout most of the litigation, Patrick Irvine, now sits on the Court of Appeals and cannot assist the Department. Indeed, the two lead attorneys whose names appear on the Motion who presumably seek to "assist the court" in understanding what Class Counsel achieved did not even appear in this litigation until January 2002 — more than 11 years after the litigation commenced! They have both openly conceded they have no experience in class action procedures. And, unlike Class Counsel, they were not involved in *Kerr III*. Thus, the Department's current counsel have nothing of special value to offer here on either the facts or the law, even if their "input" was requested and was otherwise legally and ethically proper, which is not the case.

circumstances under which the interference takes place.").[6]

Simply put, the Department's desire to be heard does not establish a legal right to be heard, and the Department lacks standing, even if its presence here were otherwise ethically proper, which it is not.

V. NEITHER THE DEPARTMENT NOR ITS ATTORNEYS ARE ETHICALLY PERMITTED TO INTERFERE WITH THEIR OPPONENT'S RELATIONSHIP WITH THEIR ATTORNEYS, NOR CAN THE ATTORNEY GENERAL PURPORT TO REPRESENT THE CLASS MEMBERS' INTERESTS WHILE SIMULTANEOUSLY REPRESENTING THE DEPARTMENT.

Unlike the situation in a typical class action where class counsel's involvement ends with the approval of a settlement, Class Counsel in this case have a continuing duty to provide ongoing legal services to the 650,000 class members for four years. The magnitude of the professional resources and the amount of expenses to deliver those services during the Settlement administration will be extraordinary. If problems should arise, an already enormous burden will become even greater.

Under the unique circumstances of this case, the fee class members are willing to pay for their attorneys' prior and future services is solely a matter for the Court and those paying the fee, and it is ethically improper for the Department or the Attorney General to attempt to control both sides of the Settlement administration — *i.e.* acting as counsel to the Department in the ongoing court supervised Settlement administration and accounting proceedings, on the one hand, while attempting to control the breadth and depth of legal resources available to their adversary by attempting to withhold or influence the amount that will be paid to counsel for the opposing side.

Indeed, the impropriety of the Department's attempt to drive a wedge between Class Counsel and the class members was pointed out by our Supreme Court in the case of *In the Matter of Fee*, 182 Ariz. 597, 601-602, 898 P.2d 975 (1995), under facts far less egregious than those present here. In *Matter of Fee*, which arose out of a medical malpractice action against the State and Pima County, the Court recognized the conflict of interest that is created when the

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[6]Moreover, this argument is essentially the same argument the Department unsuccessfully advanced in *Kerr III* — that the Court needs to scrutinize Class Counsel's hours in order to determine the fee award.

State uses tactics motivated by considerations similar to those involved here, and warned against it:

> We wish to discourage the previously-described tactic of "driving a wedge" between lawyer and client in negotiations. Although nothing in our ethical rules expressly prohibits separate offers of attorney's fees, we agree with the New York City Bar ethics committee that they frequently pose a serious dilemma for lawyers. *New York City Bar Association Committee on Professional Ethics*, formal op. 80-94. Quite simply, such offers are often intended to place attorneys in the uncomfortable position where they may be caught between their own need to be compensated for legal services and what might otherwise be in their clients' best interests. **We therefore urge judges to carefully scrutinize attempts to employ this practice.** 898 P.2d at 980 (Emphasis added.) [7]

As Mr. Zlaket explains in his Report, a form of this practice is being employed here, once again, through the Department's interference in the fee award:

> This leaves only the possibility that ADOR might be attempting to cause strife between plaintiffs' counsel and their clients, perhaps to gain a tactical or strategic advantage in future dealings. Under the settlement terms, there is considerably more work to be done in the coming years. Unhappiness and/or inadequate funding in the plaintiffs' camp would surely make it more difficult for class counsel to provide adequate continuing representation. I respectfully submit, however, that it is improper for any attorney, as an officer of the court, to interfere or attempt to interfere with another lawyer's professional duties or relationships with his or her clients.
>
> *See*, Rule 42, Rules of the Arizona Supreme Court, E.R. 2.1 (independent professional judgment); E.R. 5.4 (professional independence); E.R. 8.4 (conduct prejudicial to the administration of justice).

Moreover, as Mr. Zlaket's Report confirms, the Attorney General's attempt to oppose the amount of fees to be paid by her client's adversary places Class Counsel in a professionally untenable position, and constitutes unprofessional conduct on the part of the Department's counsel. Here, the Attorney General wishes to maintain a position that will enable her to control directly the amount of legal services that Class Counsel will be able to deliver to the class by controlling the payment of fees and expenses. Class Counsel has an obligation to the class members to maintain their professional independence. *See* ER 2.1. Neither the Department nor its counsel, the Attorney General, under the facts and circumstances of this case can legitimately

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[7]Moreover, as shown in §VI *infra*, the United States Supreme Court has expressly held that permitting such conflicts to be created by a defendant in a **class action** violates due process.

claim any cognizable interest in controlling or even attempting to influence what the class pays its lawyers. Both the law and the Settlement provide class members with a simple procedure "to assert their own rights" if they wish to challenge the fee request. *Kerr*, 3 P.3d at ¶16. The class members do not need their past and future adversary to do it for them; an adversary who has a vested interest in the outcome that is antagonistic to their interests.

It must be emphasized again that this is a class action. This Court, an experienced trial court, acts as the fiduciary for the class. *See* Report of the Third Circuit Task Force, *Court Awarded Attorney's Fees*, 108 F.R.D. 237 (1985). It will not award an unreasonable fee. Just as the North Carolina Supreme Court implicitly recognized in *Bailey* when it denied the Attorney General's appeal, this Court does not "need" the Department's unsolicited "input" to make that determination. In fact, as Mr. Zlaket explains in his Report, it would actually be improper under these facts for the Court to allow the class members' opponent, the Department, and its counsel, the Attorney General, to influence the Court's role here, where the Supreme Court has taught they have no "cognizable interest":

> Secondly, the court must be neutral in deciding this issue. If the court desires assistance, there is a wealth of outside, independent, and impartial class-action expertise to which it can turn. (*See, e.g.*, the report of Hon. Bruce Meyerson, dated September 10, 2002, regarding reasonable fees). As previously indicated, however, the state's advocates can hardly be perceived as fair and impartial consultants. They are in a clear position of conflict, having been adverse to the class, its members, its attorneys and their claims from the beginning of this hard-fought contest. And, unlike class counsel, they have no direct interest in the fee award.

Finally, even if the Department is permitted to engage in this unseemly conduct, its attorneys, who owe a higher duty to the Court and to their profession, cannot. As Mr. Zlaket points out in his report:

> There remains much work to be done in coming years to fully effectuate this settlement, and the state's attorneys will continue to be adverse. This conflict is obvious. The department's lawyers cannot now represent the interests of the taxpayers, however much they might wish to do so. *See* Rule 42, Rules of the Arizona Supreme Court, E.R. 1.7 *et. seq.* (conflicts of interest)

Mr. Zlaket therefore concludes: "the department's attorneys should [not] ethically be participating in the process of awarding fees under the circumstances of this case." *See* Report,

Exhibit "A".[8] The appearance of impropriety that would result from a contrary ruling, and the damage to the integrity of the profession it would pose, is simply too great to permit the Department and its counsel to participate at the fee hearing.

VI. PRINCIPLES OF DUE PROCESS REQUIRE THAT THE DEPARTMENT BE DENIED STANDING.

There is one other critical consideration, which is unique to class actions, that must be taken into account here. If the Department's efforts in this case to drive the fee award as low as possible are successful, it would represent more than merely the employment of improper tactics — it would constitute a fundamental violation of the class members' due process rights.

As Professor Silver explains in his Declaration, because class actions are an exception to the usual rule of due process that judgments bind only named parties, absent-parties — the class members here — can only be bound by the judgment in this case if they are adequately represented. "In recent cases, the U.S. Supreme Court has emphasized that adequate representation occurs only when trial judges regulate class actions in ways that minimize conflicts between class members and their representatives." Silver Declaration, ¶16.

Specifically, in two recent decisions the United States Supreme Court set aside billion dollar class settlements because of conflicts between class representatives and absent class members. *See Ortiz v. Fibreboard Corporation*, 527 U.S. 815 (1999); *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997). As experts in the field have recognized, to comply with the Supreme Court's due process mandate and avoid conflicts, it is important for courts to employ procedures which harmonize the interest of class representatives and absent class members. *See*

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[8]Although it did not deny standing on this basis, the Court in *Bailey* also noted the potential conflict in the approach the Department and its attorneys are pursuing here:

> Even if we were to accept the Attorney General's premise that the issue of class action attorneys' fees is of public interest and that the public is somehow effectively served by allowing a *defendant's* long-term counsel to intervene on behalf of *plaintiffs*--a questionable proposition to be sure--the power to intercede does not grant the Attorney General an unconditional license to intrude in court affairs. (Emphasis in original).

540 S.E. 2d at 321.

Charles Silver, *Due Process and the Lodestar Method: You Can't Get There From Here*, 74 Tul.L.Rev. 1809, 1811.

One of the best ways to harmonize the interest of all class members is to ensure that the interests of the class are closely aligned with the interests of class counsel, and as Professor Silver explains, fee award procedures are the most important method courts use to align interests and mitigate conflicts. *See* Silver Declaration, ¶17. The learning is overwhelming that the best way to align the interests of class members and class counsel and thereby minimize class conflict is through use of the percentage fee method. The percentage method aligns counsel's interests with the class' interests because it incentivizes class counsel.

Under the percentage method, the class' interests are maximized because as the class' recovery is increased, so is the fee award to counsel. *Id.* at 1811; 1 Conte, *Attorney Fee Awards*, §2.7 (2nd Ed 1993) ("It better aligns the financial interests of the client with that of the lawyer. It uses economic based incentives, rather than court-imposed after-the-fact controls to regulate fees") (quoting M. Malakoff, Third Circuit Judicial Conference, *Update on Third Circuit Fee Task Force Report on Court Awarded Attorneys' Fees* 10 (Sept. 13, 1991)) (emphasis in original). *See also* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 Colum. L.Rev. 669 (1986); Deborah R. Hensler et al, *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 33 (Rand. Inst. for Civil Justice).[9]

As Professor Silver cogently points out, the State of Arizona knows this, because it uses the percentage method when it hires private lawyers to recover hundreds of millions or even billions of dollars for itself. However, the lodestar method the Department now urges the Court to use here has the exact opposite result, and encourages conflicts. Why on earth would the Department switch its positions if it was truly concerned about the class members' interests?

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[9]Accordingly, the emerging trend in class actions is to set the contingency fee percentage before the first notice of certification, long before the hours are known. *See* Silver Declaration, ¶ 40.

It would not. In short, as Professor Silver opines: "the state's flip-flop is potent evidence of bad faith." Silver Declaration, ¶ 22.

In this case, given the structured installment payout and dispute resolution process provided under the Settlement, the result based compensation provided to Class Counsel under the percentage method is the only mechanism that will provide absent class members with the assurance that Class Counsel will continue to seek to maximize their recoveries. This alignment of interests is consistent with the requirements of due process that must be considered under Rule 23, *Ariz.R.Civ.P.* The Department, who has now been adverse to the taxpayers for 12 years, and will remain so for four more, seeks only to create conflict:

> The *Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request* confirms that the State is the class' enemy, not its friend. Never does the State urge the Court to regulate fees in a manner that would motivate class counsel to maximize the net value of class members' claims, even though this is what taxpayers would have done had they been able to set fees themselves. Instead, the State urges the Court to cut fees to the bone and to apply the discredited lodestar method, a fee formula that encourages sell-out settlements and delayed settlements, that creates severe conflicts between class members and their lawyers, and that, in my experience, parties to private contingent fee arrangements rarely employ.[10]

Silver Declaration, ¶21. Professor Silver therefore concludes, as this Court should: "**The Due Process Clause requires the Court to minimize conflicts between class members and class counsel when setting fees. To accomplish this, the Court must deny the defendant, the State of Arizona, any role in the fee setting process.**" Silver Declaration, at p. 9 (emphasis in original).

VII. CONCLUSION.

For all the foregoing reasons, this Court should rule that the Department has no standing to contest Class Counsel's common fund attorneys' fee award. The Court should also rule that the Department and its counsel are precluded from offering evidence or argument at the hearing

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[10] *See, e.g.*, John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 Colum. L. Rev. 669, 724 (1986) ("[T]he claim that the lodestar formula invites structural collusion" between plaintiffs' counsel and a defendant is "the most powerful" explanation for low relief/high fees settlements.).

on Class Counsel's Motion for a Common Fund Attorneys Fee Award set for December 16, 2002.

RESPECTFULLY SUBMITTED this 31st day of October, 2002.

BONN & WILKINS, CHARTERED
O'NEIL, CANNON & HOLLMAN, S.C.

By: Randall D. Wilkins
Paul V. Bonn, Esq.
Randall D. Wilkins, Esq.
D. Michael Hall, Esq.
Eugene O. Duffy, Esq.

ORIGINAL filed and a copy hand-delivered this 31st day of October 2002, to:

The Honorable Paul A. Katz
Maricopa County Superior Court
125 West Washington
Phoenix, Arizona 85003

COPY of the foregoing hand-delivered this 31st day of October, 2002 to:

Michael F. Kempner
Chief Counsel, Tax Section
Office of the Attorney General
1275 West Washington
Phoenix, Az 85007

Randall D. Wilkins

A

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Admitted to Practice in
Arizona & California

October 21, 2002

Randall D. Wilkins, Esq.
Bonn & Wilkins
805 North Second Street
Phoenix, Arizona

Re: Ladewig v. Arizona Department of Revenue

Dear Mr. Wilkins:

You have asked me to consider whether there may be ethical constraints upon attorneys for the Arizona Department of Revenue who are attempting to inject themselves and their client into the judicial process of approving a fee award for class counsel in the present case. I have reviewed the following pleadings: Plaintiffs' Motion for the Preliminary Approval of a Stipulation of Settlement and Order Regarding Notice, dated September 20, 2002; Class Counsel's Motion for a Common Fund Attorneys' Fee Award and Request for Hearing, dated September 20, 2002; and Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request, dated October 3, 2002. I have also reviewed various pieces of correspondence by and/or between counsel, together with attachments.

Quite frankly, I do not understand why the attorneys for the Department of Revenue feel compelled to take any position on the issue of fees. I seriously question their legal standing to do so under the circumstances of the present settlement, *see* Kerr v. Killian, 197 Ariz. 213, 3 P.3d 1133 (2000), but that remains a matter for the court to decide. In any event, the motivation for defense counsels' insistence on actively participating in the consideration of fees remains unclear. I can think of only a few possible reasons why ADOR would want to get involved, and in my opinion all of them have serious ethical implications for its lawyers.

(A) First of all, any suggestion that the department's attorneys are attempting to protect the interests of the plaintiff taxpayers is ludicrous. It is the state that caused the taxpayers' plight in the first instance, and its lawyers have represented the Department of Revenue in strenuously resisting any significant taxpayer relief for more than a decade. *See* ADOR v. Dougherty, 200 Ariz. 515, 516, 29 P.3d 862, 863 (2001). There is no evidence that any plaintiff has asked for their help, and no ethical way in which the state's attorneys can claim to be looking out for those parties against whom they have heretofore vigorously litigated. There remains much work to be done in coming years to fully effectuate this settlement, and the state's attorneys will continue to

be adverse. The conflict is obvious. The department's lawyers cannot now represent the interests of the taxpayers, however much they might wish to do so.

See, Rule 42, Rules of the Arizona Supreme Court, E.R. 1.7 *et. seq.* (conflicts of interest)

(B) Then again, any argument that the state's attorneys are attempting to assist the court on the fee issue should summarily be rejected. It is the court's job to set the plaintiffs' attorneys fees. It is uniquely the court's duty, not the Department of Revenue's, to see that fair, just and proper fees are awarded to class counsel. To my knowledge the court has not requested the assistance of the defendant or its counsel in this effort. Indeed, it would be extraordinary if the court did so, for several reasons.

First, the defendant is not paying the fees. This case is unlike one in which fees are being assessed against an adverse party. Here, the class members are paying their own fees. The parties have entered into a lump-sum settlement. Any member of the class having an interest in the common settlement fund certainly has the right to challenge, or comment upon, the fees and costs that will come out of that fund.

Secondly, the court must be neutral in deciding this issue. If the court desires assistance, there is a wealth of outside, independent, and impartial class-action expertise to which it can turn. (*See, e.g.*, the report of Hon. Bruce Meyerson, dated September 10, 2002, regarding reasonable fees). As previously indicated, however, the state's advocates can hardly be perceived as fair and impartial consultants. They are in a clear position of conflict, having been adverse to the class, its members, its attorneys and their claims from the beginning of this hard-fought contest. And, unlike class counsel, they have no direct interest in the fee award.

(C) This leaves only the possibility that ADOR might be attempting to cause strife between plaintiffs' counsel and their clients, perhaps to gain a tactical or strategic advantage in future dealings. Under the settlement terms, there is considerably more work to be done in the coming years. Unhappiness and/or inadequate funding in the plaintiffs' camp would surely make it more difficult for class counsel to provide adequate continuing representation. I respectfully submit, however, that it is improper for any attorney, as an officer of the court, to interfere or attempt to interfere with another lawyer's professional duties or relationships with his or her clients.

See, Rule 42, Rules of the Arizona Supreme Court, E.R. 2.1 (independent professional judgment); E.R. 5.4 (professional independence); E.R. 8.4 (conduct prejudicial to the administration of justice).

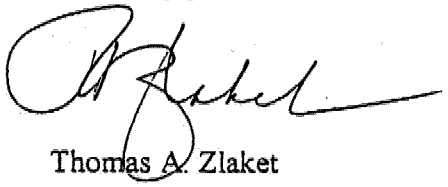
See also, In re Fee and Montijo, 182 Ariz. 597, 601, 898 P.2d 975, 979 (1995) (attempts to drive a wedge between lawyer and client over fees should be met with judicial disfavor).

(D) Finally, I am reluctant to think that the department and its attorneys could be acting out of anger, resentment, spite or malice because they failed to prevail in this hotly contested matter, or because of class counsels' success here and elsewhere. I therefore choose not to explore this possibility. While politicians might harbor petty feelings of revenge over

dissatisfaction with litigation results, more is expected of lawyers. Such conduct would clearly be both unbecoming and unprofessional.

For the foregoing reasons, I do not believe the department's attorneys should ethically be participating in the process of awarding fees under the circumstances of this case. I hope that I have answered your questions. If not, please feel free to contact me again. A reasonably current copy of my curriculum vitae is attached for your information and use.

Very truly yours,



Thomas A. Zlaket

CURRICULUM VITAE

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DATE OF BIRTH:	*MAY 30, 1941*
PLACE OF BIRTH:	*ONTARIO, CALIFORNIA U.S.A.*
MARRIED:	*AUGUST 10, 1963*
SPOUSE:	*GLORIA E. (KALIL) ZLAKET*
CHILDREN:	*THOMAS, JR., MICHAEL, PATRICIA, LORI*

Education:

University of Notre Dame, South Bend, Indiana.
Bachelor of Arts (A.B.) in Political Science, 1962.

University of Arizona, Tucson, Arizona.
Bachelor of Laws (LL.B.), 1965.

University of Virginia, Charlottesville, Virginia.
Master of Laws (LL.M.) in Judicial Process, 2001.

Admitted to Practice Law:

- *All Arizona state courts, September 25, 1965*
- *United States District Court, District of Arizona, July 27, 1967*
- *United States Court of Appeals, Ninth Circuit, July 9, 1969*
- *All California state courts, May 7, 1976*

Judicial Experience:

- *Judge Pro Tem, Superior Court of the State of Arizona, Pima County, Arizona, 1983 to 1992.*
- *Associate Justice, Arizona Supreme Court, 1992 - 1996*
- *Vice Chief Justice, Arizona Supreme Court, 1996 - 1997*
- *Chief Justice, Arizona Supreme Court, 1997 - January 7, 2002.*
- *Associate Justice, Arizona Supreme Court, January 8, 2002 – April 30, 2002.*

Private Practice of Law:

- *Lesher, Scruggs, Rucker, Kimble & Lindamood*
  3773 East Broadway Boulevard
  Tucson, Arizona 85716
  (Associate: 1965 - 1967; partner: 1967 - 1968)

- *Maud & Zlaket*
  177 North Church Avenue
  Tucson, Arizona 85701
  1968 - 1970
  (Partner)

- *Estes, Browning, Maud & Zlaket*
  Estes, Browning & Zlaket
  Estes & Zlaket
  177 North Church Avenue
  Tucson, Arizona 85701
  1970 - 1973
  (Partner)

- *Slutes, Estes, Zlaket, Sakrison & Wasley*
  Slutes, Zlaket, Sakrison & Wasley
  Slutes, Browning Zlaket & Sakrison
  33 North Stone Avenue
  Tucson, Arizona 85701
  1973 - 1982
  (Partner)

- *Zlaket & Zlaket, P.C.*
  2701 East Speedway Boulevard, Suite 200
  Tucson, Arizona 85716
  1982 - 1992
  (Shareholder)

- *Law Offices of Thomas A. Zlaket, P.L.L.C.*
  310 South Williams Boulevard, Suite 170
  Tucson, Arizona 85711-4446
  5/1/02 – present
  (Managing Member)

Professional Memberships:

State Bar of Arizona, 1965 to present:

- *Board of Governors, 1980 - 90*
  President, 1988-89
  President-Elect, 1987-88
  First Vice President, 1986-87
  Second Vice President, 1985-86

- *Injury and Wrongful Death Litigation Advisory Commission, 1990-92*

- *Committee on Professionalism, 1988 - 1992*

- *Disciplinary Probable Cause Panelist, 1986-87*

- *Committee on Criminal Rules Revision, circa 1974-76*

- *Certified Specialist, Injury and Wrongful Death Litigation, 1991-92*

Pima County Bar Association, 1965 to present:
Board of Directors, 1969 - 70; and 1980 - 90

- *Civil Practice Committee, 1985 - 90*

- *Medical - Legal Committee, 1980 - 85*
  (Chairman, circa 1984 - 85)

- *Courthouse Committee, 1975 - 80*

- *Medical - Legal Screening Panel, 1968 - 75*

State Bar of California, 1976 to present.

Maricopa County Bar Association, 1992 - present.

Fellow, American College of Trial Lawyers, 1982 - present
- *Arizona State Chairman, 1991 - 92*

Life Fellow, American Bar Foundation.

National Conference of Chief Justices, 1997 - 2002.
- *Board of Directors, 1998 - 2000*

Founding Fellow, Arizona Bar Foundation.

American Bar Association, 1966 to present.
- *Arizona Delegate, ABA House of Delegates, 1990 - 92*

American Board of Trial Advocates, 1972 - present
- *National Executive Committee, 1982 - 85*
- *President, Tucson Chapter, 1981*
- *Secretary/Treasurer, Tucson Chapter, 1980*

Defense Research Institute, 1970 - 82
- *Arizona State Chairman, circa 1975 - 78*

Tucson Defense Bar Association, 1970 - 82
- *President, circa 1977 - 78*

American Trial Lawyers Association, 1972 - 91

Arizona Trial Lawyers Association, 1985 - 91

American Judicature Society, circa 1968 - 80; 1992 - present

National Panel of Arbitrators, American Arbitration Association, circa 1975 – 91

Federal Civil Justice Reform Act Advisory Committee for the District of Arizona, 1991 - 95

Arizona Supreme Court Commission on the Courts, 1988 - 90

Arizona Governor's Task Force on Medical Liability Insurance Premiums, 1989 - 90

Arizona Supreme Court Committee on Medical Malpractice Rules of Procedure, 1989 - 92

Chairman, Arizona Supreme Court Committee on Civil Discovery Abuse, Cost & Delay, 1990 - 92

Chairman, Arizona Supreme Court Committee on Technology, 1992 - 97

Arizona College of Trial Advocacy Executive Committee, 1986 - present

Teaching Faculty, Arizona College of Trial Advocacy (State Bar of Arizona), 1986 - present

Teaching Faculty, National Institute of Trial Advocacy, Western Session, San Diego, California, 1988

Teaching Faculty, Hastings College of Trial Advocacy, San Francisco, California, circa 1978 - 80

Teaching Faculty, Pima County Bar Association Trial Advocacy Program, 1989 - 90

Lecturer-in-Law, University of Arizona College of Law, 1967 – 78.

Lecturer at numerous continuing legal education seminars in Arizona and around the

United States from 1970 to the present, primarily on the subjects of professionalism, civil litigation, and discovery abuse.

Chairman, Attorneys' Planning and Program Committee for the Arizona Judicial Conference, 1990

University of Arizona Law College Association, 1975 - present.
- *Board of Directors, 1990 - present*

Arizona Law Review Association, 1986 - present

Co-chair, National Conference on Public Trust and Confidence in the Justice System, Washington, D.C., May 1999

Phi Delta Phi Legal Fraternity
- *President, Pattee Inn, 1964 – 65*

Student Bar Board of Governors, University of Arizona College of Law, 1963

Honors and Awards:

Honorary Doctor of Law Degree, University of Arizona, 2002

Distinguished Alumnus Award, University of Arizona James E. Rogers College of Law, 2002

2001 National Center for State Courts' Reardon Award

State Bar of Arizona James A. Walsh Distinguished Jurist Award, June 15, 2001

American Judges Association 2000 Chief Justice Richard W. Holmes Award of Merit

State Bar of Arizona Award of Special Merit, June 16, 2000

University of Arizona Distinguished Citizen Award, February 21, 1998

American Board of Trial Advocates Civil Justice Award, April 1, 1992

Member of the Year Award, State Bar of Arizona, June 1991

Outstanding Graduate Award, University of Arizona College of Law, 1989

Arizona Supreme Court Certificate of Appreciation for Service on Board of Governors, 1988

State Bar of Arizona Award for Contribution to Continuing Legal Education, 1988

City of Tucson Copper Certificate for Service on Magistrate Selection Commission, 1982

Listed in three editions of "The Best Lawyers in America" before going on the bench

Martindale-Hubbell AV rating before going on the bench

Arizona Law Review, 1963 - 65
- *Editor-in-Chief, 1964 - 65*
- *Editorial Staff, 1963 - 64*

National Moot Court Team, University of Arizona College of Law, 1964 - 65
- *Regional Finalists, Albuquerque, New Mexico, 1965*

Individual Moot Court Champion, University of Arizona College of Law, 1962 - 63, 1963 - 64, and 1964 - 65

Tucson Title Insurance Award, University of Arizona College of Law, 1965

Udall on Evidence Award, University of Arizona College of Law, 1965

AmJur Awards in Trust and Corporations, University of Arizona College of Law, 1964 - 65

Other Associations and Activities:

Tucson Conquistadores (Life Member) 1977 - 92
- *Board of Directors, 1981 - 84*
- *President, 1983 - 84*

Arizona Academy, 1988 - present.
- *Delegate, Arizona Town Hall on Civil Justice, 1988*

City of Tucson Magistrate Selection Commission, 1997 - 82

Big Brothers of Tucson Board of Directors, circa 1970 - 75

St. Joseph's Hospital Community Advisory Committee, circa 1975 - 80

Exchange Club of Downtown Tucson, circa 1970 - 80

"Off the Record" Debate Society
- *Board of Directors, 1991 - 93*

Articles:

*Casenote, 6 Arizona Law Review 156, "Second Mortgagee May Not Acquire Title to Mortgaged Property as Against First Mortgagee Through a Tax Deed — **Moore vs. Crisp** (Okla. 1963)."*

President's Message, "Reviving Professionalism," Arizona Attorney, September 1988

President's Message, "God Bless Madison Avenue," Arizona Attorney, October 1988

President's Message, "Dispute Prevention," Arizona Attorney, November 1988

President's Message, "Paper Wars," Arizona Attorney, December 1998

President's Message, "A Town Hall View of Lawyers and Justice," Arizona Attorney, January 1989

President's Message, "Out of the Frying Pan . . .," Arizona Attorney, February 1989. (Republished in the ALI-ABA CLE Review, Vol. No. 6, March 10, 1989.)

President's Message, "A Learned Profession?," Arizona Attorney, March 1989

President's Message, "Don't Worry, Be Happy?," Arizona Attorney, April 1989

President's Message, "Letters... We get Letters," Arizona Attorney, May 1989

President's Message, "So Long, It's Been Good to Know You ...," Arizona Attorney, June 1989

"Encouraging Litigators to be Lawyers: Arizona's New Civil Rules", 25 Arizona State L. J. 1 (1993).

"Should Lawyers Be Required to Tell the Truth?" (unpublished) Masters Thesis, U of Virginia (2000)

(Rev. 6/27/02)

B

THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN THE ARIZONA TAX COURT

ESTATE OF HELEN H. LADEWIG, on behalf Of itself and the class of all persons in the State Of Arizona who, during any one of the years 1986 to 1989 paid income taxes to the State of Arizona on dividends paid by corporations whose principal business was not attributable to Arizona, et al.,	§	No. TX 97-00075
Plaintiffs,	§	
vs.	§	
ARIZONA DEPARTMENT OF REVENUE and its Director, in his official capacity,	§	
Defendants.	§	

DECLARATION OF PROFESSOR CHARLES SILVER

I, Charles Silver, declare as follows:

CREDENTIALS

General

1. I am the Co-Director of the Center on Lawyers, Civil Justice, and the Media and the Cecil D. Redford Professor at the University of Texas School of Law. I joined the faculty in 1987, received tenure in 1991, and was a visiting professor at the University of Michigan Law School in 1994. I have taught, researched, written, and consulted with lawyers on class actions and attorneys' fees for more than ten years. Before becoming a professor, I studied the economics of collective actions and class actions as a graduate student at the University of Chicago and as a law student at Yale

Law School. All told, I have published almost 40 major writings, many focusing on subjects relevant to this litigation.

Class Actions and Other Group Lawsuits

2. I have studied and written about the law and economics of group lawsuits and class actions for many years. My published and forthcoming works include:

- Charles Silver, *We're Scared to Death: Class Certification and Blackmail*, *New York University Law Review* (forthcoming 2003);
- Charles Silver, *Law and Economics of Class Actions and Group Lawsuits*, *International Encyclopedia of Law and Economics* (2000);
- Lynn A. Baker and Charles Silver, *The Aggregate Settlement Rule and Ideals of Client Service*, 41 *South Texas Law Review* 227 (1999);
- Charles Silver and Lynn Baker, *I Cut, You Choose: The Role of Plaintiffs' Counsel in Allocating Settlement Proceeds*, 84 *University of Virginia Law Review* 1465 (1998);
- Charles Silver & Lynn Baker, *Mass Lawsuits and the Aggregate Settlement Rule*, 32 *Wake Forest Law Review* 733 (1997);
- Charles Silver, *Comparing Class Actions and Consolidations*, 10 *Texas Review of Litigation* 496 (1991); and
- Jules Coleman and Charles Silver, *Justice In Settlements*, 4 *Social Philosophy and Policy* 102 (1986).

My writings have been cited in leading treatises and other authorities, including the *Manual (Third) for Complex Litigation* (1996).

3. I also have substantial non-academic experience with class actions. I have submitted briefs amicus curiae on class action issues to the Supreme Courts of Texas and the United States. I have testified before and submitted written comments to the Advisory Committee on the Rules of Practice and Procedure of the Judicial Conference of the United States regarding proposed amendments to the federal class action rule. I was the principal author of an amicus brief submitted to the U.S. Supreme Court on behalf of a group of law professors in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), urging affirmance of the Third Circuit's standard for the certification of settlement classes. The Supreme Court affirmed on the issues addressed in the brief. I have also testified as an expert witness on class action issues, including certification, settlement, and attorneys' fees, many times in state and federal courts.

Attorneys' Fees

4. I have written at length about the subject of attorneys' fees and fee awards, including fee awards in class and other types of group actions. My published works include:

- Charles Silver, *A Critique of* Arce v. Burrow, 26 *William & Mary Environmental Law & Policy Review* 323 (2001);

- Charles Silver, *Due Process and the Lodestar Method: You Can't Get There From Here, Tulane Law Review* (2000);

- Charles Silver, *Flat Fees and Staff Attorneys: Unnecessary Casualties in the Battle over the Law Governing Insurance Defense Lawyers*, 4 *Connecticut Insurance Law Journal* 205 (1998);

- Charles Silver, *Incoherence and Irrationality in the Law of Attorneys' Fees*, 12 *Review of Litigation* 301 (1993);

- Charles Silver, *Unloading the Lodestar: Toward a New Fee Award Procedure,* 70 *Texas Law Review* 865 (1992); and

- Charles Silver, *A Restitutionary Theory of Attorneys' Fees in Class Actions*, 76 *Cornell Law Review* 401 (1991).

I have submitted expert affidavits and testified as an expert on attorneys' fees many times and in many locations, including federal and state courts, the U.S. House of Representatives, and the Texas legislature. My writings have been cited in treatises, law review articles, and supreme court opinions in several states.

Professional Responsibility

5. I have taught a survey course in professional responsibility law many times, and I now offer a class that focuses exclusively on litigation, under the title Professional Responsibility for Civil Litigators. I am a former member of the Executive Committee of the Professional Responsibility Section of the Association of American Law Schools. My writings in this field are extensive and include the following:

- Charles Silver, *When Should Government Regulate Attorney-Client Relationships? A Call for Inaction*, *Arizona Law Review* (forthcoming 2002);

- Ellen Smith Pryor and Charles Silver, *Defense Lawyers' Professional Responsibilities: Part II—Contested Coverage Cases*, 15 *Georgetown Journal of Legal Ethics* 30 (2001);

- Charles Silver and Frank B. Cross, Review Essay, *What's Not To Like About Being A Lawyer?*, *Yale Law Journal* (2000);

- Ellen Smith Pryor and Charles Silver, *Defense Lawyers' Professional Responsibilities: Part I--Excess Exposure Cases*," 78 *Texas Law Review* 599 (2000);

- Charles Silver, *The Legal Establishment Meets the Republican Revolution*, 37 *South Texas Law Review* 1247 (1996);

- Charles Silver, *Professional Liability Insurance as Insurance and as Lawyer Regulation: A Comment on Davis*, Institutional Choices in the Regulation of Lawyers, 65 *Fordham Law Review* 233 (1996);

- Charles Silver, *Integrating Theory and Practice into the Professional Responsibility Curriculum at the University of Texas*, 58 *Law & Contemporary Problems* 213 (Summer/Autumn 1996) (multiple authors);

- Charles Silver and Michael Sean Quinn, *All Clients are Equal, But Some are More Equal than Others: A Reply to Morgan and Wolfram*, 6 Coverage 47 (May/June 1996);

- Charles Silver and Michael Sean Quinn, *Are Liability Carriers Second-Class Clients? No, But They May Be Soon--A Call to Arms against the Restatement of the Law Governing Lawyers*, 6 *Coverage* 21 (Jan./Feb. 1996);

- Charles Silver and Michael Sean Quinn, *Wrong Turns on the Three Way Street: Dispelling Nonsense About Insurance Defense Lawyers*, 5 *Coverage* 1 (Nov./Dec. 1995);

- Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 *Duke Law Journal* 255 (1995); and

- Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?* 72 *Texas Law Review* 1583 (1994).

6. In 1997, a program sponsored jointly by the Insurance Law and Professional Responsibility Sections of the Association of American Law Schools was devoted to my work on the professional responsibilities of insurance defense lawyers. My work in this area significantly influenced the *Restatement of the Law Governing Lawyers*, produced by the American Law Institute. The American Bar Association relied on my work in Formal Opinion 96-403: Obligations of Lawyers Representing an Insured Who Objects to a Proposed Settlement Within Policy Limits (1996).

7. I have testified as an expert witness on professionalism issues many times.

Arizona Ties

8. I have given talks at continuing legal education and scholarly programs in Arizona several times. In 2002, I participated in a conference hosted by the University of

Arizona School of Law in Tucson. The program included presentations by Justices Feldman and Zlaket, of the Arizona Supreme Court, as well as academic talks by leading scholars from Arizona and other states. My presentation focused on the professional responsibilities of insurance defense lawyers. The article on which my remarks were based is forthcoming in the *Arizona Law Review*.

9. Arizona courts have cited my writings with approval. The Arizona Supreme Court relied on one of my articles in *Paradigm Ins. Co. v. The Langerman Law Offices*, 24 P.3d 593 (Arizona 2001). The Arizona court of appeals did so in the same case. *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*, 2 P.3d 663 (Ariz. App. Div. 1 1999). The Arizona tax court relied on my article on attorneys' fees in class actions in *Kerr v. Killian*, 955 P.2d 49 (Ariz. Tax 1998).

DOCUMENTS REVIEWED

10. In preparing to express the opinions stated in this Declaration, I have reviewed many documents relating specifically to this lawsuit, including but not limited to:

- Process for Resolution of Attorneys' Fees Claim, prepared by Bruce Meyerson
- Declaration of Allen Nahrwold, C.P.A.
- December 2, 1997 Affidavit of Eugene O. Duffy (filed in *Kerr v. Killian*)
- March 19,1998 Supplemental Declaration of Eugene O. Duffy (filed in *Kerr v. Killian*)

- Motion for the Preliminary Approval of a Stipulation of Settlement and Order Regarding Notice (including attachements)
- Recommendation Re Reasonable Attorneys' Fee, prepared by Bruce E. Meyerson
- Class Counsel's Motion for a Common Fund Attorneys' Fee Award and Request for Hearing
- Department of Revenue's Motion to Approve Settlement
- Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request
- Report of Thomas A. Zlaket, P.L.L.C., October 21, 2002.

I also reviewed secondary materials relating generally to class actions, including articles published in law reviews, treatises, empirical studies, cases, and other items.

SUMMARY OF OPINIONS

11. Opinion 1: The Due Process Clause requires the Court to minimize conflicts between class members and class counsel when setting fees. To accomplish this, the Court must deny the defendant, the State of Arizona[1], any role in the fee setting process.

[1] As used herein, the phrase "State of Arizona" includes the Arizona Department of Revenue and its Director, and their attorneys.

12. Opinion 2: The Due Process Clause requires the Court to minimize conflicts between class members and class counsel when setting fees. To accomplish this, the Court must not make a "lodestar comparison."

13. Opinion 3: The Court should not allow discovery of class counsel's time records or otherwise allow the process of setting fees to become protracted litigation. Instead, the Court should use a simple, market-based contingent percentage approach.

14. Opinion 4: A fee of 12 percent of the recovery for the class would be permissible under prevailing national ethical standards and Arizona law.

ANALYSIS

Opinion 1. The Due Process Clause requires the Court to minimize conflicts between class members and class counsel when setting fees. To accomplish this, the Court must deny the defendant, the State of Arizona, any role in the fee setting process.

15. The class action is a recognized exception to the usual rule of due process that judgments bind only persons named as parties in lawsuits. Non-parties can be bound when they are adequately represented.

16. In recent cases, the U.S. Supreme Court has emphasized that adequate representation occurs only when trial judges regulate class actions in ways that minimize conflicts between class members and their representatives. *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999). In *Ortiz;* the Supreme Court specifically recognized the importance of minimizing conflicts between class members and class counsel. The issue there was whether a single group of attorneys could represent class members with divergent interests. The Supreme Court

answered with an emphatic "no." Class members with divergent interests had to be separated and represented by lawyers who were loyal to them alone.

> [A] class divided between holders of present and future claims ... requires division into homogeneous subclasses under Rule 23(c)(4)(B), with separate representation to eliminate conflicting interests of counsel.

Ortiz, at 856 (emphasis added). In a footnote to this statement, the Court reiterated its concern with "the 'competency and conflicts of class counsel.'" *Ortiz*, at 856, n. 31 (emphasis added).

17. The methods available for mitigating interest conflicts in class actions include subclasses, notices, interventions and objections, and opt-out rights. Although these devices are important, fee award procedures are more important by far. A presiding judge can best protect a group of absent plaintiffs by giving class counsel good incentives, and the best way to do this is by using the contingent percentage method of compensation. *Absent plaintiffs can safely rely on a lawyer whose primary interest is in maximizing the value of their claims. They cannot rely on a lawyer whose primary interest lies elsewhere.* The recent RAND study of class actions agrees: "The single most important action that judges can take to support the public goals of class action litigation is to reward class action attorneys only for lawsuits that actually accomplish something of value to class members and society." Deborah R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 33 (RAND Inst. for Civil Justice 1999). To connect rewards to results, the RAND study advises judges to "award fees in the form of a percentage of the fund actually disbursed." *Id.* at 34.

18. The due process imperative thus requires a trial judge presiding over a class action to select a fee formula that rewards class counsel for maximizing the value of absent plaintiffs' claims. Class members would have chosen such a formula themselves had they been able to bargain with their attorneys face to face at the outset of this litigation.

19. The State of Arizona has no interest in encouraging the Court to adopt such a compensation arrangement. It is the taxpayers' enemy, not their friend. The State benefits by minimizing refunds; taxpayers benefit by maximizing them. Consequently, the State will oppose any fee arrangement that encourages a lawyer for a taxpayer to maximize the amount refunded. Worse, the long-term interest of government officials who violate the law is to discourage plaintiffs' attorneys from bringing cases like this one. To accomplish this, they will predictably attempt to persuade the Court to use inferior fee arrangements and to set fees lower than taxpayers (and other victims) would rationally want, so that lawyers will refuse to accept new cases and conflicts between lawyers and class members will be maximized. If they succeed, the "danger" of private law enforcement will disappear and public officials will be free to exploit taxpayers (and other victims) with impunity. To allow the State to participate in the process of setting fees would be to throw the Due Process Clause to the winds and to risk the destruction of incentives for private law enforcement.

20. The facts of this case demonstrate the strong antagonism between class members and the State of Arizona. This lawsuit has already lasted twelve years. By class action standards, this is an eternity. A study conducted by the Federal Judicial Center found that the median time from filing to disposition of non-prisoner class actions

was about 15 months. Securities class actions lasted slightly longer, with a median duration slightly less than two years. Thomas E. Willging, Laural L. Hooper & Robert J. Niemic, *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules*, Figure 9 (Federal Judicial Center 1996). The State of Arizona made this lawsuit last six times longer than normal and held onto taxpayers' money the entire time, despite being in the wrong. The State's assertion that it is the taxpayers' friend and is "in the best position to comment on the reasonableness of Class Counsel's time" is LAUGHABLE. *Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request*, p. 8.

21. The *Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request* confirms that the State is the class' enemy, not its friend. Never does the State urge the Court to regulate fees in a manner that would motivate class counsel to maximize the net value of class members' claims, even though this is what taxpayers would have done had they been able to set fees themselves. Instead, the State urges the Court to cut fees to the bone and to apply the discredited lodestar method, a fee formula that encourages sell-out settlements and delayed settlements, that creates severe conflicts between class members and their lawyers, and that, in my experience, parties to private contingent fee arrangements rarely employ.[2]

22. Comparing the State's position on fees in this lawsuit to the position it took in its own tobacco case reveals the State's object plainly. When seeking to recover hundreds of millions or even billions of dollars for itself, the State promised to pay a

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2 See, e.g., John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 Colum. L. Rev. 669,

contingent fee of 18 percent. It used the contingent percentage approach, not the lodestar method; it promised to pay the market rate, which greatly exceeded the 12 percent ceiling set by the mediator here; and it did not contract for a lodestar comparison. Why the dramatic switch in this case? The State is now a defendant, not a plaintiff. When the State's sought to recover money, it used the compensation method of choice in the market, promised the market rate, and demonstrated that its interest lay primarily in the results obtained, not in the hours expended to accomplish them. As a defendant seeking to keep ill-gotten gains, however, the State wants to prevent taxpayers from using the very same fee arrangement it employed. It knows that market-based contingent percentage arrangements encourage lawyers to fight zealously for plaintiffs, and it does not want taxpayers to use them. The State's flip-flop is potent evidence of bad faith.[3]

23. When thinking about the State's incentives, one must also remember that the settlement process in this lawsuit will extend over several years and will require the State to determine refunds for thousands of taxpayers. Class counsel will have to review the refunds to ensure that the State processes them accurately and compensates taxpayers fully. Having been through many class action settlements, I can tell the Court that defendants sometimes abuse claims processes to avoid paying full dollars on valid claims. For this reason, it is important to give class counsel a contingent percentage interest in every dollar paid out. When it is profitable for class counsel to see that all

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724 (1986) ("[T]he claim that the lodestar formula invites structural collusion" between plaintiffs' counsel and a defendant is "the most powerful" explanation for low relief/high fees settlements.).

[3] Additional evidence may be found in the State's acceptance a percentage-based award in In re Coordinated Pretrial Proceedings in Petroleum Products Antitrust Litigation, 1994 WL 675265 (D. Cal. 1994).

claims are paid in full, class members gain. Naturally, the State has no interest in such an arrangement.

24. The State's participation in the fee setting process prior to this point has already endangered taxpayers and other potential class members. As the Court knows, the State insisted on meddling in the fee-setting process (even though it had neither standing nor any legitimate interest in doing so), and its intransigence led to a mediation process that set a ceiling on the fee of 12 percent. Evidence of fee arrangements prevailing in private markets strongly suggests that the ceiling percentage is too low to encourage lawyers to take class actions and litigate them zealously. If the 12 percent figure survives and becomes a precedent for future fee awards in Arizona, many class actions that might have been brought on behalf of persons with meritorious cases will never materialize. Government officials and other actors will then be free to violate the law secure in the knowledge that few victims will obtain relief.

25. This lawsuit is an example of an extremely important kind of private litigation. It is a lawsuit brought to force a government agency to respect the boundaries of law. The classic problem of governance is to prevent officeholders from exceeding their authority and exploiting citizens. Private litigation in independent courts has been an effective means of addressing this need. Unfortunately, public officials regard lawsuits like this one as embarrassing nuisances. They would rather violate the law with impunity than have their illegal acts brought to light. Consequently, they use all available means to discourage private attorneys from bringing suits like this one. The Court must courageously resist political pressures to destroy the incentive to bring private lawsuits

and must exclude the State from the fee-setting process for this reason. At stake is nothing less than the survival of government under law.

Opinion 2. The Due Process Clause requires the Court to minimize conflicts between class members and class counsel when setting fees. To accomplish this, the Court must not make a "lodestar comparison."

26. I have repeatedly pointed out that the lodestar method "is a source of many problems and has been widely condemned." Charles Silver, *Unloading the Lodestar*, supra, at 867. I have also written that "[t]he consensus that the contingent percentage approach creates a closer harmony of interests between class counsel and absent plaintiffs than the lodestar method is strikingly broad." Charles Silver, *Due Process and the Lodestar Method*, supra, at 1819. The consensus includes leading academics,[4] researchers at the RAND Institute for Civil Justice,[5] and many judges,[6]

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[4] See, e.g., Coffee, supra note 2, at 724-25 ("[T]he highest priority should be given to those reforms [of class action procedure] that restrict collusion and are essentially self-policing. The percentage of the recovery fee award formula is such a "deregulatory" reform because it relies on incentives rather than costly monitoring. Ultimately, this "deregulatory" approach is the only alternative."); Richard A. Posner, Economic Analysis of Law § 21.9, at 568 (4th ed. 1992) ("[M]aking the lawyer's fee vary with the success of his effort is a way of giving him an incentive to do a good job."); Robert E. Litan & Steven C. Salop, More Value for the Legal Dollar: A New Look at Attorney-Client Fees and Relationships 27 (ABA Section of Litig. 1992) (distributed at the ABA Annual Meeting, Aug. 9-12, 1992) (on file with author) ("Of all possible types of fee arrangement, contingency fees in principle do the best job of aligning the lawyer's interest in doing a good job at least cost with those of the client in obtaining the best results for the money.").

[5] Deborah R. Hensler et al., Class Action Dilemmas: Pursuing Public Goals for Private Gain 33-34 (RAND Inst. for Civil Justice 1999) (urging greater use of result-based compensation).

[6] In the opinion finally approving the settlement and fee award in Shaw v. Toshiba America Information Systems, Inc., 91 F. Supp. 2d 942, 963 (E.D. Tex. 2000), Judge Thad Heartfield commented on the decreasing use of the lodestar method in federal class actions: "Today, the First, Third, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Eleventh Circuit Courts, along with the District of Columbia, either allow judges to use the percentage method or require them to do so." Other authorities, including the Manual for Complex Litigation and the Federal Judicial Center's empirical study of class actions, also chronicle the lodestar's decline. They find that the percentage method is increasingly popular and that the lodestar method is not. See Manual for Complex Litigation, Third § 24.122, at 191 (1995); Thomas E.

including those who contributed to the *Manual for Complex Litigation*,[7] the *Report of the Federal Courts Study Committee*,[8] and the report of the Third Circuit Task Force.[9] Indeed, it is difficult to find anyone who contends otherwise. "No one writing in the field today is defending the lodestar on the ground that it minimizes conflicts between class counsel and absent claimants." Charles Silver, *Due Process and the Lodestar Method*, supra, at 1820.

27. In view of this, it is as clear as it possibly can be that judges should never use the lodestar method when they can apply the contingent percentage method instead. The Due Process Clause requires judges to minimize conflicts between absent claimants and their representatives. The contingent percentage approach accomplishes this best. By using the lodestar method, judges needlessly saddle absent plaintiffs with conflicts and thereby foster legitimate due process complaints.

28. In keeping with its manifest desire to prevent taxpayers from using superior incentive arrangements, the State contends that the Court must make a lodestar comparison even if the Court bases the fee primarily on a contingent percentage of the recovery. This is a brazen attempt to sneak in through the side door a guest who is likely to be refused admission through the front. When the contingent percentage method is employed, no lodestar comparison is required and none should be made.

Willging et al., An Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules 68-76 (Federal Judicial Ctr. 1996). Thomas E. Willging et al., An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges, 71 N.Y.U. L. Rev. 74, 156 (1996).

[7] Manual for Complex Litigation, Third § 24, at 186- 200 (1995) (criticizing the lodestar method as being "difficult to apply, time-consuming to administer, inconsistent in result, and capable of manipulation").

[8] Report of the Federal Courts Study Committee 105 (Apr. 2, 1990) (encouraging further study of percentage-based fee awards).

[9] Third Circuit Task Force, Court Awarded Attorney Fees, 108 F.R.D. 237, 254-59 (1985).

29. The *Manual for Complex Litigation*, at § 24.12 correctly observes that "'[t]he Supreme Court [has] never formally adopted the lodestar method in a common fund case.'" (quoted in *Shaw v. Toshiba America Information Systems, Inc.*, 91 F. Supp. 2d 942, 963 (E.D. Tex. 2000).[10] The *Manual* also states quite plainly that "[u]nlike in a statutory fee analysis, where the lodestar is generally determinative, in a percentage fee award [from a common fund] *the amount of time may not be considered at all.*" *Manual*, § 24.121, at 191 (emphasis added).[11] Many judges have quoted this passage from the *Manual* with approval. For a list of cases applying the percentage method, see *Shaw v. Toshiba America Information Systems, Inc.*, 91 F. Supp. 2d 942 (E.D. Tex. 2000). Neither the lodestar method itself nor a lodestar comparison is required.

30. *Venegas v. Mitchell*, 495 U.S. 82 (1990), supports this view. *Venegas* held that the amount a losing defendant must pay a prevailing plaintiff pursuant to a fee award statute is one thing; the amount a plaintiff must pay his or her attorney is another; and the lodestar method governs only the former. *Id.* at 90. *Venegas* was a single-client representation, not a class action, but it makes the relevant point. The lodestar does not govern fee relationships between plaintiffs' attorneys and plaintiffs.

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[10] The State implies that Hensley v. Eckerhart, 461 U.S. 424 (1983), requires the Court to apply the lodestar method in this case. See *Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request*, p. 4. This is ludicrous. The question in *Hensley* was how much the defendant owed the prevailing plaintiffs pursuant to a fee award statute, not how much the attorneys should be paid from a common fund. As I explain in the text, Venegas v. Mitchell, a post-*Hensley* decision, clearly established that the lodestar does *not* regulate fees between plaintiffs' lawyers and plaintiffs. The State ignores *Venegas*. The State also ignores *Amchem* and *Ortiz*, the Supreme Court cases requiring conflict-minimization.

[11] Schweiger v. China Doll Restaurant, Inc. 673 P.2d 927 (Ariz. App. 1983), is not to the contrary. The issue there was how much a losing defendant should pay a prevailing plaintiff in fees pursuant to a fee-shifting contract, given that the plaintiff was paying its lawyer by the hour. The distinction between fee shifting cases and common fund cases is longstanding.

31. In this case, the issue is how much taxpayers should pay the lawyers who won the case for them. Under *Venegas*, this is not an appropriate matter for lodestar analysis. Ordinarily, it is a matter that lawyers and clients resolve contractually when representations begin. In class actions, it is a matter a court handles using market-based principles. As Judge Richard A. Posner, of the U.S. Court of Appeals for the Seventh Circuit, explained in a class action context, "it is not the function of judges in fee litigation to determine the equivalent of the medieval just price. *It is to determine what the lawyer would receive if he were selling his services in the market rather than being paid by court order.*" *In re Continental Illinois Securities Litigation*, 962 F.2d 566, 568 (7th Cir. 1992) (emphasis added).[12]

32. Lodestar comparisons are not mandatory. They also are undesirable, because they destroy the advantages of the percentage approach.[13] The percentage approach encourages class counsel to maximize absent plaintiffs' recoveries, the only thing absent plaintiffs care about. The simple logic that the lawyer earns more when the class recovers more is extremely potent. Lodestar comparisons weaken the connection between high fees and good outcomes by forcing lawyers to worry about the number of hours they expend. This is bad for class members, not good. To them, a dollar today is worth more than a dollar next year. When lodestar comparisons are made, however, the same need not be true for lawyers. Rather than win big quickly, a lawyer may earn a

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[12] Judge Posner reiterated the point in *In the Matter of Continental Illinois Securities Litigation*, 985 F.2d 867, 868 (7th Cir. 1993), stating that "[t]he class counsel are entitled to the fee they would have received had they handled a similar suit on a contingent fee basis, with a similar outcome, for a paying client."

[13] The State contends that "the major difficulty with the lodestar method is that at times it may consume enormous judicial resources." *Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request*, p. 5. Without meaning to deny that the burden the lodestar method imposes on the courts is a

larger fee by winning slowly. A lawyer who wins slowly can log a larger number of hours than one who wins quickly. Consequently, when time (rather than results) is the gold standard, a lawyer who serves a class relatively poorly can earn more.

33. A lodestar comparison also recreates the risk of a sell out settlement. In this case, class counsel held out for an extremely large recovery and now faces an angry defendant that seeks to prevent them from being paid. They held out because they expected to be paid on a percentage basis, knowing they would be paid more if the class won more. Had they anticipated a lodestar-based award or a lodestar comparison, they would have had an incentive to curry the State's favor by accepting a low-ball settlement in return for a promise from the State not to challenge their fees.

34. Empirical studies of class actions clarify this point. These studies show that fee awards average around 30 percent of the recovery, excluding expenses, regardless of the size of the common fund. In this case, a 12 percent fee award from a $350 million recovery would equal $42 million. At a 30 percent rate, one could generate a $42 million fee off of a common fund recovery of only $140 million. An opportunity therefore existed for the State and class counsel to have the following conversation: State: "You want us to pay $350 million. If you insist on that, we'll fight your fee every step of the way. If you accept $140 million instead, we'll agree not to contest your application for a fee of up to 30 percent. Courts routinely approve fees in that range. If you need to log more hours to justify a 30 percent lodestar award, we'll put off formal announcement of the settlement until you accumulate enough time and we'll provide

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major drawback, I deny that it is the worst defect. The adverse impact on lawyers' incentives and, indirectly, on claimants' well being is far more important.

opportunities for discovery to help you get there. You could spend thousands of hours looking at old tax records alone." Class Counsel: "Hmmm." If class counsel had agreed, class members would have lost $210 million.

35. Whether applied directly or used as a comparative standard, the lodestar method encourages defendants and class counsel to collude. The contingent percentage approach discourages collusion and encourages class counsel to maximize claims values. No wonder the State (like any other defendant that attempts to meddle with class counsel's fees) is pressing hard for the lodestar.

36. The percentage approach also frees judges from having to serve as accountants. Lodestar comparisons waste judges' time by requiring them to review and assess the reasonableness of time and expense records. The percentage approach eliminates this burden. In common fund contexts, the lodestar method also requires judges to set enhancements intended to compensate lawyers for payment delays, non-payment risks, interest on expenses, and other factors. It is difficult and perhaps even impossible for judges to set these enhancements accurately, there being few market-based proxies for them. Because judges are subject to significant political pressures to cut fees, they err on the low side, producing a situation in which lawyers are discouraged from taking class actions. James H. Stock and David A. Wise, *Market Compensation in Class Actions Suits: A Summary of Basic Ideas and Results,* 16 *Class Action Reports* 584-604 (1993).

37. For these reasons, the tendency to check the reasonableness of contingent percentage fee awards by comparing them to lodestar-based fees should be reserved for cases in which the value of the recovery is unclear because the recovery is not in cash.

This is the situation that existed in *Bloyed v. General Motors Corp.*, 916 S.W.2d 949, 961 (Tex. 1996), where the Texas Supreme Court wrote that "on remand any fee awarded on a percentage basis should be tested against the lodestar approach." The *Bloyed* settlement was a coupon deal, and the value of these settlements is notoriously prone to being exaggerated. Because taxpayers in this case will receive cash, there is no need for a lodestar comparison and none should be made. As the federal judge presiding over the enormous Phen-Fen settlement recently said, "[t]he day of the lodestar has passed in class actions such as this, save for perhaps its use as a cross-check in some cases," namely, those where the value of relief is unclear. *In re: Diet Drugs (Phentermine, Fenfluramine, Dexfenfluramine) Products Liability Litigation*, MDL Docket No. 1203, Memorandum and Pretrial Order No. 2622 (Oct. 3, 2002), p. 19. In the Phen-Fen case, no lodestar cross-check was made.

Opinion 3. The Court should not allow discovery of class counsel's time records or otherwise allow the process of setting fees to become protracted litigation. Instead, the Court should use a simple, market-based contingent percentage approach.

38. No law requires class counsel to keep or submit fee records when the contingent percentage compensation method is used. See *Manual for Complex Litigation* § 24.211 (saying that time records are "critical" in lodestar situations but only "advisable" in others). In this respect, class actions are like other contingent fee representations. Lawyers who work for contingent percentage fees rarely keep time records and routinely charge clients without providing them. The point of the contingent

fee is to compensate lawyers for incurring risks and producing results, not to encourage them to churn hours.

39. The State contends that "[a] percentage is an arbitrary figure absent a detailed accounting of the services provided" and that, without a lodestar check, "the percentage of the fund approach ... can often result in a windfall." *Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request*, pp. 3-4. These assertions are utterly false.

40. First, the emerging trend in class actions is to set contingent percentage fees before the first notice of certification is distributed, so that class members will know how much participation in a class action is likely to cost them early in the course of litigation. I argued for the use of this procedure in *Unloading the Lodestar*, supra, and I have participated in several Texas class actions where this was done. The *Manual for Complex Litigation*, §24.21, now also recommends this procedure, which includes establishing "the range of likely percentages" at or near the time of certification.

41. Obviously, one cannot know at the start of class litigation how many hours class counsel will eventually expend. Yet, following the model of plaintiffs in contingent fee representations, judges presiding over class actions are setting percentages early on. According to the State, this procedure is impossible because it necessarily operates without a "detailed accounting of the services provided." It being the recommended procedure, the State must be wrong.

42. Second, in the private market, lawyers and clients set non-arbitrary contingent percentage fees and non-arbitrary bonus fees every day without detailed accountings or lodestar cross-checks. Some highly sophisticated clients, including

insurance companies and large commercial entities, hire lawyers on terms that do not require time keeping. See Charles Silver, *Flat Fees and Staff Attorneys*, supra (describing flat fee arrangements with contingent bonuses used by insurance companies). Many clients see the fact that certain fee arrangements eliminate the need to audit hours as a significant plus.

43. A famous case involving the Texas law firm of Vinson & Elkins (V&E) exemplifies the use of contingent percentage compensation arrangements by sophisticated clients seeking large recoveries. In the *ETSI Pipeline* case, ETSI Pipeline Project (EPP) sued Burlington Northern Railroad and other defendants, alleging a conspiracy on their part to prevent it from constructing a $3 billion coal slurry pipeline. In a sworn affidavit, Harry Reasoner, V&E's managing partner, described the financial relationship between EPP and V&E.

> The terms of our retention were that our client would pay all out-of-pocket expenses as they were incurred, but all legal fees were contingent upon a successful outcome. We were paid 1/3 of all amounts received by way of settlement or judgment. We litigated the matter for 5 years. At the conclusion, we had settled with all defendants for a total of $634,900,000.00. As a result, a total of $211,633,333.00 was paid as contingent legal fees.

Declaration of Harry Reasoner, filed in *In re Washington Public Power Supply System Securities Litigation*, U.S. District Court, District of Arizona, MDL No. 551, Nov. 30, 1990.

44. When class counsel requests a contingent percentage fee award, a court guards against arbitrariness by checking the percentage against the market rate and historical fee award practices. Scholars have amassed data on both.[14] They have studied contingent fees in a variety of private market contexts, including personal injury cases, medical malpractice cases, asbestos cases, airplane crash cases, and others. They have also tracked fee awards in class actions, especially securities cases, and fee payments in public lawsuits, including state tobacco cases, *qui tam* cases, and tax collection cases. By relying on these data, a court can be reasonably confident of setting a fee at the market rate. Here, the data consistently show that the 12 percent ceiling set by the mediator is well below market.

45. A decision to allow discovery of class counsel's time sheets would necessarily open an enormous can of worms. First, time records must be examined and confidential and privileged information deleted. Otherwise, class counsel would risk revealing this strategic and protected information to a litigation adversary that would use it to advantage if a settlement were rejected. See *Arizona Attorneys' Fees Manual* § 1.9. Second, matters only get worse after records are disclosed. A court must expect extended battles over attorney-client and work product privileges and extended depositions in which each set of lawyers forces the other to explain why so much time was expended. Third, once the issue becomes the reasonableness of the hours class counsel expended, class counsel must be allowed to offer evidence showing that the time expended was reasonable. This evidence includes the *defense attorneys'* time records. The *Manual for*

[14] I intend to submit a second report summarizing the available data and expressing my opinions on the reasonableness of the requested common fund fee award for the benefit of the Court.

Complex Litigation § 24.231 states this explicitly: "Having defendants submit billing records. Where defendants oppose plaintiff's counsel's fee request, records showing defendants' attorneys' fees may provide a reference for determination of the level of reasonable fees." A court that allows discovery of time records must expect a free-for-all.

46. Because hours are not important when contingent percentage arrangements are employed, in common fund cases "[d]iscovery in connection with fee motions should rarely be permitted." *Manual for Complex Litigation* § 24.224. Discovery is, of course, precisely what the State demands in its *Department of Revenue's Motion to Set Deadline to Substantiate Attorneys' Fee Request*. Rather than allow the Court to use a simple, market-based contingent percentage approach that encourages lawyers to maximize claim values, it would embroil the Court in burdensome litigation over fees. Thus, the State would have the Court consider whether time was spent on "attorney fee issues," whether time was spent "on other cases," whether time expended was "reasonable and not duplicative." These tasks are wholly unnecessary. They will accomplish nothing of value but will waste substantial amounts of the Court's time.

47. The State's effort to create an enormous accounting project runs squarely contrary to the U.S. Supreme Court's repeated admonition that lower court judges should prevent requests for fee awards from generating major litigation. *Hensley v. Eckerhart*, 461 U.S. 424, 437 (1983). See also *Pennsylvania v. Delaware Valley Citizens' Council for Clean Air*, 483 U.S. 711, 722 (1987) ("Fee litigation ... should be simplified to the maximum extent possible."). The *Arizona Attorneys' Fees Manual* § 1.10.1 (3d ed. 1998), reiterates this admonition. The State's effort to base the fee award solely on time

expended to date also threatens to undermine class counsel's incentive to argue zealously for class members during the refund administration process.

48. A decade ago, I urged courts to jettison the lodestar method and to adopt simplified fee setting procedures.

> Lawyers who work for paying clients in contingent-fee cases usually know how much their clients owe and usually have little difficulty securing payment. By contrast, lawyers who handle fee- shifting cases often have no way of knowing when or how much they ultimately will be paid, and they often have to fight to collect their fees. Even a victory at trial offers no assurance of prompt payment. All too often the conclusion of the battle on the merits marks the beginning of a protracted struggle over fees.
>
> In my judgment, it is as important to deliver fee awards predictably and efficiently as it is to mimic the market in other respects.... No fee award process can [perfectly] duplicate the results a market would produce. Because mistakes are inevitable, the best one can hope for is a procedure that gets things right in the mill run of cases and that operates at acceptable expense. That is the kind of process I have strived to create ....

Charles Silver, *Unloading the Lodestar*, supra, at 870. Today, this Court faces a choice. It can step back in time to the days when the lodestar method encouraged sell-out

settlements and burdened judges and parties with protracted, expensive, and essentially pointless fee litigation. Or it can step into the modern era of value-added compensation arrangements that encourage lawyers to maximize claim values and that are largely self-administering.

49. The State wants the Court to take a step backward. Having litigated the merits for twelve years and lost, it wants to fight a second protracted battle over fees. Its aim is the selfish and mean-spirited one of discouraging future tax refund class actions by making these cases unprofitable for lawyers. The tobacco companies used the same strategy in personal injury cases. Their success was so complete that, for decades, it was all but impossible to find private attorneys willing to sue them. I urge the Court to resist the governmental pressure being applied and to opt for the contingent percentage approach.

Opinion 4: A fee of 12 percent of the recovery for the class is proper under prevailing national ethical standards and the Arizona ethics rules.

50. In this case, class counsel requests a fee equal to 12 percent of the recovery. This section will consider the propriety of this request under national and state ethical rules.

51. Prevailing national ethical standards for attorneys' fees are indicated by Rule 1.5 of the American Bar Association's Model Rules of Professional Conduct and § 34 of the *Restatement (Third) of the Law Governing Lawyers*. The Arizona rule on fees, ER 1.05, is based on Model Rule 1.5.

52. Generally, the referenced rules allow lawyers to charge fees that are reasonable under the circumstances, and they establish factors in light of which reasonableness may be assessed. Not all factors need be applied in all circumstances. I say more on this below.

53. Both prevailing national standards and Arizona ER 1.05 explicitly allow lawyers to charge contingent percentage fees. Contingent percentage fees are common in all American states and are widely used in class actions. I know of no jurisdiction that has used its ethics rules to prevent attorneys from employing this form of compensation. To the contrary, the A.B.A.'s most thorough advisory opinion on contingent fees, Formal Opinion 94-389, reaffirmed the permissibility of contingent percentage compensation in diverse contexts, including contexts where clients can afford to pay hourly rates.

54. Having read innumerably many judicial and advisory opinions on fees, I can also report that, to my recollection, no jurisdiction has ever struck down a contingent fee of 12 percent on ethical grounds. To the contrary, contingent fees above 12 percent prevail in all jurisdictions in all manner of representations. Fees in class actions also routinely exceed this level. Empirical studies consistently show that fee awards average about 30 percent of the recovery, excluding costs.

55. Some judges believe that ethics rules require them to assess the permissibility of contingent percentage fees by calculating lawyers' effective hourly rates. This is error. As I explained in an article published in the *Tulane Law Review*, "The Hourly Rate Is Not the Standard of Reasonableness for Contingent Fee Representations." Charles Silver, *Due Process and the Lodestar Method*, supra, at 1824.

> State bar ethics rules do not enshrine the hourly rate as a one-size-fits-all measure of the reasonableness of attorneys' fees. They recognize that lawyers and clients employ diverse approaches to compensation, including hourly rates, contingent percentages, flat fees, salaries, and hybrid arrangements, and they admit the propriety of applying different criteria to different arrangements. In particular, the ethics rules recognize that the reasonableness of contingent fees should be assessed in light of risks incurred and results obtained. Nothing in the rules requires one to supplement these standards with hourly rate comparisons. Contingent fees that are reasonable on a risks-and-results approach are completely proper, regardless of the hourly rates they yield and even if the hourly rates are unknown.

Id.

56. The argument supporting this conclusion starts with the Canons of Ethics, adopted by the American Bar Association in 1908. The Canons made it clear that no particular yardstick had a claim to exclusivity. Canon 12, which contained essentially the same factor list as Model Rule 1.5 and Arizona ER 1.05, provided that "[n]o one of these considerations in itself is controlling. They are mere guides in ascertaining the real value of the service.' *Canons of Professional Ethics, Canon* 12 (1967). The point of enumerating the factors was to identify an array of considerations that may bear on the reasonableness of fees, not to sanctify the hourly rate. It would be anachronistic to think

otherwise. The hourly rate is a creature of the mid-twentieth century. It was not a popular method of charging for legal services when Canon 12 was enacted. See George B. Shepherd & Morgan Cloud, *Time and Money: Discovery Leads to Hourly Billing*, 1999 *University of Illinois Law Review* 91, 93-98 (discussing the growing use of hourly rate arrangements during the 1960s and 1970s). By contrast, contingent fees were an established method of billing when the twentieth century began. See 2 Floyd R. Mechem, *A Treatise on the Law of Agency* § 2236, at 1811-12 nn. 87-90 (2d ed. 1914) (citing cases involving contingency fee arrangements).

57. Both A.B.A. Formal Opinion 94-389 and the Restatement (Third) of the Law Governing Lawyers agree that risks incurred and results obtained are independently sufficient standards of reasonableness that need not be supplemented by reference to hourly rates. If such supplementation were required, one would expect these authorities to say so. Neither does.

58. In Formal Opinion 94-389, the ABA Committee on Ethics and Professional Responsibility went out of its way to be clear that the reasonableness of a contingent fee does not depend on the amount of time a lawyer actually expends.

> If a lawyer accepts a given risk--for example, the risk posed by the fact that the opposing party has a reputation for being intransigent in its approach to settlement— ... the lawyer should not be required as a matter of ethics to give up the benefit of the agreement because the opposing party, to everyone's surprise, offers an early settlement that is acceptable to the client.... Changes in conditions may

> cause a lawyer's effective hourly rate to be unexpectedly high or unexpectedly low. Regardless, the fee agreed to is proper, so long as the percentage was reasonable in light of the risks that were incurred and is justified on the basis of the results obtained.

ABA Comm. on Ethics and Professional Responsibility, Formal Op. 94-389 (1994). Plainly, effective hourly rates provide no yardstick for contingent percentage fees.

59. The *Restatement (Third) of the Law Governing Lawyers* contains two sections that bear on the reasonableness of contingent fees: § 34 relating to fee arrangements in general and § 35 focusing specifically on contingent fees. Section 34 provides that "[t]he percentage in a contingent-fee contract should be compared to percentages commonly used in similar representations for similar services," and that events occurring after a percentage is set, "such as a high recovery, do not make unreasonable an agreement that was reasonable when made." *Restatement (Third) of the Law Governing Lawyers* § 34 cmt. c. (2000-2002). Section 35 allows judges to find contingent fees unreasonable only when there is "a defect in the calculation of risk" or when "the percentage rate is excessive or the base against which the percentage is applied is excessive or otherwise unreasonable." *Restatement (Third) of the Law Governing Lawyers* § 35 cmt. c. Neither § 34 nor § 35 establishes the hourly rate as the standard for assessing the reasonableness of contingent percentage fees.

60. In sum, existing ethics rules do not require judges to measure the reasonableness of contingent fees by calculating lawyers' effective hourly rates. The tendency to do so reflects nothing more than the fact that today's lawyers came of age at

a time when hourly billing was widespread. As contingent fees and other forms of value-based billing become more popular, lawyers will find it increasingly natural to gauge reasonableness in terms of risks and rewards. At some point, those who persist in identifying the hourly rate as the gold standard may come to seem quaint.

I hereby declare on penalty of perjury that the foregoing is true and correct.

10/28/04
Date

Charles Silver

C

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Attorneys for Plaintiffs

IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

ESTATE OF HELEN H. LADEWIG, on behalf of itself and the class of all persons in the State of Arizona who, during any one of the years 1986 to 1989 paid income taxes to the State of Arizona on dividends paid by corporations whose principal business was not attributable to Arizona, et al.,

Plaintiffs

vs.

ARIZONA DEPARTMENT OF REVENUE and its Director, in his official capacity,

Defendants.

No. TX 97-00075

DECLARATION OF RANDALL D. WILKINS

(Assigned to the Honorable Paul A. Katz)

RANDALL D. WILKINS hereby declares as follows:

1. I am over 18 years of age and make this Declaration based upon personal knowledge of the facts contained herein.

2. I am an attorney duly licensed to practice law in the State of Arizona and am a member of the State Bar of Arizona, in good standing.

3. I have served as co-counsel for the representative Plaintiff and the Plaintiff class ("Plaintiffs") in this action together with Paul V. Bonn, Esq. and D. Michael Hall, Esq. of the

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firm of Bonn & Wilkins, Chartered and with Eugene O. Duffy, Esq., of the law firm of O'Neil, Cannon & Hollman, S.C. (collectively referred to as "Class Counsel").

4. I have been involved in this litigation from the filing of the initial court action, CV91-00125 ("*Ladewig I*") and the filing of the class refund claim with the Department of Revenue (the "Department").

5. Messrs. Bonn, Hall, Duffy and I are also currently representing the Plaintiffs in litigation known as *Kerr v. Killian*, which was initially commenced in 1991 against the Department and was known as *Kerr v. Waddell*. I have been actively involved in the *Kerr v. Killian* litigation since its commencement.

6. Although *Kerr v. Killian* was initially class certified, the certification order was later vacated by the Court of Appeals. *See Kerr v. Waddell*, 185 Ariz. 457, 916 P.2d 1173 (App. 1996) ("*Kerr II*"). Following the decision in *Kerr II*, a new action was commenced, TX97-00119 (consolidated). The Trial Court denied class certification in that case. The denial of class certification, among other issues, is currently before the Arizona Court of Appeals in 1 CA-TX 00-0023.

7. On March 25, 1997, the named Plaintiffs in the *Kerr* litigation achieved a favorable decision before the Arizona Board of Tax Appeals (the "Board") for tax years 1985 to 1990, in which the Board ruled that Arizona's discriminatory tax on federal employees' mandatory retirement contributions violated 4 U.S.C. § 111.

8. The Department subsequently conceded the illegality of the tax for said years and began to pay refunds to some of the other similarly situated taxpayers who had filed timely individual refund claims.

9. Plaintiffs' counsel thereafter applied for an injunction from the Arizona Tax Court enjoining the Department from, *inter alia*, dispersing refunds until Plaintiffs' counsel's claim for a common fund attorney fee award could be determined. On or about December 5, 1997, Judge Cates enjoined the Department from making further refunds.

10. On or about March 3, 1998, Judge Cates issued a written minute entry ruling that

the common fund doctrine applied in that case, set a hearing on April 3, 1998, to determine the amount of attorneys' fees to be awarded to Plaintiffs' counsel, and ordered the Department to mail a copy of his ruling and order setting the hearing to each federal employee entitled to a refund. Judge Cates thereafter recused himself, and the matter was assigned to Judge Sylvan Brown to preside over the fee hearing, which was held on April 3, 1998.

11. At the April 3, 1998 hearing on Plaintiffs' counsel's fee request, Judge Brown questioned the Department's standing to participate in the fee hearing, stating:

> Mr. Irvine, before you begin, I do have a question, and let me preface it with the fact that I am going to listen to you and I'm going to permit you to cross-examine, but I'm interested in what standing the attorney general has to appear and apparently represent the people that you fought for eight years to keep from getting any refunds and now represent them in saying that they shouldn't have to pay any attorney's fees for the refunds that they got . . . But you fought the taxpayers of Arizona for eight years to keep them from getting any money . . . Where do you get standing now to represent them in saying that they should get the money you refused to give them which you could have given them back in 1990 very simply without any trouble, couldn't you?

A true and correct copy of the quoted excerpts of the Transcript of Proceedings, pp. 16-18, are attached as Exhibit "1" hereto.

12. On or about April 7, 1998, Judge Brown issued a written minute entry ruling in which he awarded Plaintiffs' counsel 20 percent of the common fund, and ordered the Department to withhold 20 percent of the refunds it was paying and to also separately account to Plaintiffs' counsel for those funds. The order included the 26 refunds that the Department had paid before Judge Cates issued his injunction which the Department paid out of State funds.

13. The Department thereafter appealed Judge Brown's 20 percent award, contending, *inter alia*, that the common fund doctrine did not apply, that the fees claimed and awarded were excessive, that the Court erred by not basing the award on counsel's hours instead of a percentage, and that the notice procedure used violated the taxpayers' due process rights. True and correct copies of the Tables of Contents of the Department's Opening and Reply Brief filed in the *Kerr III* appeal are attached hereto as Exhibit "2".

14. The Plaintiffs challenged the Department's right to appeal, arguing, *inter alia*, that the Department was not aggrieved by the Judgment and also that it had no standing to assert the taxpayers' due process rights.

15. The Department argued that governmental defendants have standing to challenge common fund fee awards and also that the Department was aggrieved by the Judgment. True and correct copies of the pages from the Department's Reply Brief filed in *Kerr III*, in which the Department set forth its standing arguments, are attached hereto as Exhibit "3". The Court of Appeals ruling in that case is found at 197 Ariz. 213, 3 P.3d 1113 (App. 2000) (*Kerr III*).

16. In connection with the *Kerr v. Killian* litigation, the Department was represented at all times by the Arizona Attorney General's Office. The only attorneys at the Arizona Attorney General's Office who ever appeared in the litigation were Gail Boyd, Patrick Irvine, Christine Cassetta and Scott Keiper. None of the counsel currently representing the Department in this case ever appeared as counsel of record in the *Kerr v. Killian* litigation.

17. The only attorneys whose names appear on the Department's Opening Brief filed in *Kerr III* are Grant Woods, Arizona Attorney General and Patrick Irvine, Assistant Attorney General. The Brief was signed by Patrick Irvine as Assistant Attorney General on November 25, 1998.

18. The Department's Reply Brief in *Kerr III* was filed with the Court of Appeals on March 26, 1999. The only attorneys whose names appear on the Department's Reply Brief are Janet Napolitano, Arizona Attorney General, and Patrick Irvine, Assistant Attorney General. The Brief was signed by Patrick Irvine as Assistant Attorney General on March 26, 1999.

19. Since the commencement of the *Ladewig* litigation in 1991. The Department has been represented at all times by the Arizona Attorney General's Office.

20. When the Department's Answer was filed in *Ladewig I* on April 29, 1991, the only attorneys whose names appeared on the Answer were Grant Woods, Arizona Attorney General, Gail H. Boyd and Patrick Irvine, Assistant Attorney Generals. Ms. Boyd retired several years ago from the Arizona Attorney General's Office.

21. Mr. Irvine and Ms. Christine Cassetta are the only Assistant Attorney Generals whose names are mentioned in the Arizona Court of Appeals' and the Arizona Supreme Court's Opinion in the *Ladewig* litigation.

22. Mr. Irvine represented the Department in the *Ladewig* litigation from April 1991 until approximately January 2002, when he informed Class Counsel that Michael Kempner, Assistant Attorney General, would be handling the matter. Prior to that time, Mr. Kempner had not appeared in the *Ladewig* litigation.

23. On several occasions, Mr. Kempner informed Eugene O. Duffy and myself that he was not familiar with the background of the *Ladewig* case and could not comment on what had occurred before he became involved.

24. During the course of the current *Ladewig* settlement negotiations in 2002, Lisa Neuville, Assistant Attorney General, also appeared for the first time in this case on behalf of the Department.

25. During the course of the *Ladewig* settlement negotiations, both Ms. Neuville and Mr. Kempner represented to Class Counsel that they did not have any prior experience in class action proceedings.

26. On or about October 10, 2002, Class Counsel learned that the Director of the Department of Revenue, Mark Killian, appeared on KAET Television's Horizon program to discuss the *Ladewig* case. In the course of the interview, Director Killian was specifically asked about Class Counsel's 12% fee request and he admitted that 12% was fair:

Moderator:	$30 to $40 million in attorneys' fees. Do I understand this correctly?
Killian:	That's correct.
Moderator:	Is that under advisement by the judge?
Killian:	**The mediator between the state and the plaintiff's attorneys has made a recommendation of not more than 12% on the attorneys fees. And that's something that the judge will have to decide whether he wants to accept. In other types of cases, class action lawsuits, you've seen payouts being as high as 33%.**

So from a fiduciary standpoint, we think 12% is fair, but we're going to leave it up to the judge to decide whether he wants to lower that or not.

Moderator: Because that sum, whatever that sum may be, is deducted actually from the corpus of the refund amount, roughly $350 million?

Killian: That's correct. The administration and the legal fees come out of that $350 million.

A true and correct copy of the transcript of the Horizon program, downloaded from KAET's website, is attached hereto as Exhibit "4" and a true and correct copy of the videotape of the program is attached to the Court's copy (only) as Exhibit "5." A copy of the tape has already been provided to the Department.

27. Upon confirming the Director's binding admission, Class Counsel made written demand on both the Department and the Attorney General that they cease any further efforts to interfere with the fee request, pointing out Arizona law absolutely precludes an attorney from denying a claim that has already been conceded, citing *James Cooke & Hobson, Inc. v. Lake Havasu Plumbing & Fire Protection*, 177 Ariz. 316, 868 P.2d 329, 334 (1993) (attorney violates Rule 11 by denying a claim without a valid reason.) A true and correct copy of Class Counsel's letter of October 16, 2002, is attached hereto as Exhibit "6."

28. On October 17, 2002, the Department's attorneys responded to Class Counsel's letter, refusing to drop their interference. A true and correct copy of the Department's counsel's response letter is attached hereto as Exhibit "7."

29. Eugene O. Duffy, one of the Class Counsel in this case, served as a fairness expert in the *Bailey* tax refund litigation in North Carolina, and Mr. Duffy is very familiar with the facts and procedure of that case. Mr. Duffy has concluded that the arguments the Department made both in the mediation and in its recent Motion bear a striking similarity to the arguments unsuccessfully advanced by the North Carolina Attorney General in *Bailey*, with whom the Department's counsel appear to have consulted.

30. In connection with the mediation, Eugene O. Duffy and myself interviewed Michael I. Spiegel, Esq., who was the lead counsel in the *Petroleum* antitrust case in which the

Arizona Attorney General participated as co-class counsel in a common fund recovery. We learned from our interview that class counsel in that case required, as a term of the settlement, that the defendants would have no say in the common fund attorneys' fee award.

31. I declare under penalty of perjury that the foregoing is true and correct.

DATED this 31 day of October, 2002.

Randall D. Wilkins

IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

CLARK J. KERR, et al.,	)	
	)	
Applicant,	)	
	)	
vs.	)	No. TX 97-00119
	)	
MARK W. KILLIAN, et al.,	)	
	)	
Respondent.	)	
	)	

Phoenix, Arizona
April 3, 1998

BEFORE: THE HONORABLE I. SYLVAN BROWN
Retired Superior Court Judge

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Hearing to Determine Attorney's Fees

Deanna Sanborn, RPR
Court Reporter

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(COPY)

We think the 20 percent requested should be awarded and I point out too, your Honor, there does not appear to be any competent evidence in the record to support a material reduction. We request, therefore, that the Court grant the 20 percent.

I and my co-counsel are willing and prepared to answer any questions you may have or may think appropriate including under oath, sir. And at this time and if the Court doesn't have any questions, we would like at this time to offer some live expert testimony from Gerald Strick.

THE COURT: You can proceed.

MR. BONN: Thank you, sir.

MR. WILKINS: I'm Randall Wilkins on behalf of the plaintiffs. I'd call at this time Gerald Strick.

THE COURT: Wait a minute. I'm sorry. Why don't you have a seat in the jury box. You made opening statements and I didn't give Mr. Irvine a chance. Why don't you have a seat for a minute and we will see if Mr. Irvine wants to give an opening.

Mr. Irvine, please, I'm sorry. I apologize.

MR. IRVINE: Thank you, your Honor.

THE COURT: Mr. Irvine, before you begin, I do have a question, and let me preface it with the fact that I am going to listen to you and I'm going to permit you to cross-examine, but I'm interested in what standing the

attorney general has to appear and apparently represent the people that you fought for eight years to keep from getting any refunds and now represent them in saying that they shouldn't have to pay any attorney's fees for the refunds that they got.

MR. IRVINE: Well, your Honor, I'm always here representing the taxpayers of Arizona. Sometimes it's a larger group than others.

THE COURT: But you fought the taxpayers of Arizona for eight years to keep them from getting any money.

MR. IRVINE: That's correct, your Honor.

THE COURT: Where do you get standing now to represent them in saying that they should get the money you refused to give them which you could have given them back in 1990 very simply without any trouble, couldn't you?

MR. IRVINE: Your Honor, we don't claim to represent any of those individual people. The Department does have a strong interest in protecting the integrity of the tax process, the tax refund process, and the authorities cited to you as showing that the holder of a common fund does not have standing, generally do not involve government.

I can give you a citation. This is actually a case which the plaintiffs have cited in their own pleadings and that's how I found it. It's Swedish Hospital Corporation vs. Shalela, 1 Federal 3rd, 1261D, circuit 1993.

Footnote one, which points out that the government does have standing in cases where there's a claim of a common fund that the government has and in that footnote as cited, other District of Columbia circuit cases as well as a Fourth Circuit decision and a Ninth Circuit decision.

The Ninth circuit decision refers to it as ancillary standing. Certainly here where the order was that the Court would hear any interested party, the Department is certainly interested.

ARIZONA COURT OF APPEALS

DIVISION ONE

CLARK R. KERR and BILLIE SUE KERR, husband and wife, SUSAN MORAN, STEVE ALLEN and JOHN UDALL, individually and as representatives of the class comprised of federal employees who paid Arizona income taxes on federal retirement contributions during one or more of the years 1984 to date,
Plaintiffs-Appellees,

v.

MARK J. KILLIAN, in his capacity as Director of the Arizona Department of Revenue, the ARIZONA DEPARTMENT OF REVENUE of the State of Arizona,
Defendants-Appellants.

STATE OF ARIZONA, ex rel., the ARIZONA DEPARTMENT OF REVENUE,
Plaintiffs-Appellants,

v.

CLARK J. KERR and BILLIE SUE KERR, husband and wife,
Defendants-Appellees.

CLARK J. KERR AND BILLIE SUE KERR, husband and wife; AND THEIR ATTORNEYS, BONN, LUSCHER, PADDEN & WILKINS, CHARTERED and O'NEIL, CANNON & HOLLMAN, S.C.,
Counterclaimants-Appellees,

v.

STATE OF ARIZONA, ex rel., the ARIZONA DEPARTMENT OF REVENUE,
Counterdefendants-Appellants.

No. 1 CA-TX 98-0014

Arizona State Tax Court
No. TX97-00119
Cons w/TX 97-00131, TX97-00150

OPENING BRIEF OF THE ARIZONA DEPARTMENT OF REVENUE

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(Firm State Bar No. 14000)
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Attorneys for Arizona Department of Revenue

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REPLY BRIEF OF THE ARIZONA DEPARTMENT OF REVENUE

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ARIZONA COURT OF APPEALS

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Brief. There is no new information and Attorneys merely seek to reargue the point.

In any event, it is plain that the Department is aggrieved by the Judgment because it directly imposes financial liabilities and obligations on it. *See* Response to Motion to Dismiss, attached as Appendix B to Attorneys' Answering Brief. Attorneys' argument should be rejected.

III. THE DEPARTMENT HAS STANDING TO CHALLENGE THE AWARD OF FEES.[1]

Attorneys argue that the Department has no standing to challenge the award of fees because the money at issue does not belong to it. The award of fees from a common fund plainly and directly affects the Department because it leads to liability for certain refunds and imposes significant costs on the Department for providing the inevitable and mandatory notice to all taxpayers entitled to refunds. Moreover, the generally accepted rule is that a governmental defendant has standing to challenge common fund fee awards.

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[1] The Answering Brief lumps together the standing and the party "aggrieved" issues, but the issues are legally distinct. Attorneys' reargument of the "aggrieved" issue on pages 16, 17, 19, 22, 23 and 25 of their brief should be disregarded for purposes of the standing issue.

In *Kuhnlein v. Department of Revenue*, 662 So.2d 309 (Fla. 1995), the Supreme Court of Florida rejected the argument that the State lacked standing to challenge a fee award in a tax refund case, stating:

> In class actions that result in the creation of a common fund the interest of class counsel in obtaining fees is adverse to interests of the class. Class counsel's role in these cases essentially changes from one of fiduciary for the class to claimant against the clients' fund created for the clients' benefit. Accordingly, class counsel is not in a position to effectively represent the interests of the class in respect to the assessment of attorney fees and costs.
>
> It is self-evident, however, that the State has an interest in protecting its citizens from excessive fees or costs which would diminish the amount of the tax refund they are entitled to receive from the common fund in this case. We conclude that this interest provides an adequate basis for standing and that the Attorney General is the proper representative of that interest.

662 So.2d at 311 (citations omitted). This recognition that the government has standing in a common fund case has been uniformly recognized by the federal courts. *Swedish Hospital Corp. v. Shalala*, 1 F.3d 1261, 1265 n.1 (D.C. Cir. 1993); *Jackson v. U.S.*, 881 F.2d 707, 710-11 (9th Cir. 1989); *Freeman v. Ryan*,, 408 F.2d 1204, 1205-06 (D.C.Cir. 1968) ("We think it is one aspect of the interest of Government officials in the programs they administer, an interest that is not to be narrowly and technically confined so as to limit presentation to courts of issues

they consider to have significance in terms of their overall responsibilities as public officials.").

Attorneys' implication that *Jackson* is somehow inconsistent with *Swedish Hospital* and *Freeman,* Answering Brief at 25 n. 10, reads more into the *Swedish Hospital* footnote than is really there. In all three cases, government standing was recognized. Moreover, the footnote questioned standing "once the fund has been established and the government has surrendered all control over it." 1 F.3d at 1265 n.1. In that case the government paid the money into a settlement fund. In this case, the only "fund" liable are the general assets of the State and the State remains liable to taxpayers entitled to refunds.

The two common fund cases cited by Attorneys, *Brown v. Phillips Petroleum Co.*, 838 F.2d 451 (10th Cir. 1988) and *Schmidt v. Apple Valley Health Care Center, Inc.*, 469 N.W.2d 349 (Minn. App. 1990), involved only private defendants. They are unhelpful in the context of a governmental defendant that has a specific and continuing relationship with taxpayers whose refunds are being assessed attorneys' fees. The other case Attorneys cite, *Niles v. City of San Rafael*, 116 Cal.Rptr. 733 (App. 1974), is not a common fund case at all.

Arizona standing law is not to the contrary. *State v. B Bar Enterprises, Inc.*, 133 Ariz. 99, 101, 649 P.2d 978, 980 (1982), recognized that standing in the

Arizona courts is not constitutionally required, but "solely a matter of judicial restraint." Given that fee awards from a common fund of taxpayer refunds is an issue of great public importance that is likely to recur, *Sears v. Hull*, 192 Ariz. 65, 71, 961 P.2d 1013, 1019 (1998), the standing of the Department should be accepted.

Even more on point, *B Bar Enterprises* recognized that a party may have standing to protect the constitutional rights of a third person if (1) the party has a substantial relationship to the third person, (2) the third person must be unable to assert the constitutional right on his or her own behalf, and (3) the failure to grant the party standing must result in a dilution of the third person's constitutional rights. Each of these factors is present here.

First, as the Supreme Court of Florida noted in *Kuhnlein,* "the State has an interest in protecting its citizens from excessive fees or costs which would diminish the amount of the tax refunds they are entitled to receive." 662 So.2d at 311. Each year the proper tax liability of each taxpayer is of substantial concern to both the Department and the taxpayers. Attorneys' connection with any of these taxpayers is temporary and slight. The Department's relationship as an agency of the State of Arizona with each taxpayer is substantial and continuing.

Second, Attorneys essentially concede that no taxpayer will challenge their fee claim when they argue that the small size of the refunds at issue means taxpayers will not be able to pursue their claims. Answering Brief at 54. If the average refund is only about $600, the average fee claim must be only about $120, 20% of that amount. The cost of intervention, as well as the real possibility of Attorneys asserting a claim for costs and fees against any intervenor, effectively preclude any taxpayer from entering the litigation merely to dispute the fee claim.

Third, and for similar reasons, if the Department is not recognized as having standing to raise issues relating to common funds taxpayers will not only suffer a dilution of their constitutional rights, but any rights will be eliminated. Indeed, because the court must act as a fiduciary for the taxpayers whose refunds Attorneys claim, *Court Ordered Attorney Fees*, 108 F.R.D. 237 (3rd Cir. 1985), the courts should encourage the Department to raise any issue that will assist the courts in carrying out that fiduciary duty. For this reason, even the Department's claim that the award violates the due process rights of the taxpayers should be considered by the Court, because the courts have a fiduciary duty to protect all the rights of the taxpayers.

Attorneys' reliance on *Hadrath v. Longnecker*, 121 Ariz. 606, 592 P.2d 1262 (1979) is misplaced. In that case, the appellant challenged a statute

governing adoptions, claiming that the statute deprived natural fathers of due process. The court noted, however, that his role in the adoption was that of an adoptive father, and that "we consider the adoption order to be a legal benefit to him, one for which he himself petitioned, and one which gave him all the legal rights and benefits of a parent." *Id.* at 609, 592 P.2d at 1265. In the present case the award of fees from a common fund certainly does not benefit the Department and the Department did not seek it. Moreover, the direct harms to the Department from costs of giving notice and liability for certain refunds flow directly from the common fund determination that the Department has challenged from the beginning. *Hadrath* is simply not on point.

Attorneys' claim that the appeal should be dismissed because the Department lacks standing should be rejected.

IV. AN AWARD OF FEES FROM A COMMON FUND IS NOT APPROPRIATE UNDER THE FACTS OF THIS CASE.

Attorneys raise issues that are not before the Court. Answering Brief at 26-30. The Department does not challenge the existence of the common fund doctrine, nor does the Department argue that common fund fee awards are never appropriate in any type of tax case. The issue here is whether an income tax refund case can ever give rise to a common fund, and, most particularly, whether

>> Michael: Tonight on "Horizon," you might have an extra tax refund coming, hundreds of thousands of Arizona taxpayers will share in a multi-million dollar settlement.

>>> Plus, caring for our elderly population. We speak with a Mesa family who shared their story for a national PBS documentary and we'll tell you where you can get resources and information.

>>> Good evening, I'm Michael Grant.

>>> First tonight, a federal appeals court is upholding Arizona's law requiring minors to get parental consent to have an abortion. The 9th U.S. Circuit Court of Appeals today upheld how the state deals with cases in which a girl wants to have an abortion but does not get permission from a parent or guardian. Opponents had argued that the process violates a girl's privacy rights.

>>> The State Department of Revenue has started notifying more than 600,000 Arizona taxpayers they may be due a refund from the proposed settlement of a class action lawsuit. That case stems from income taxes paid on dividends received from the out of state corporations in the late 1980s. An Arizona law exempted dividends from the state income tax if the corporation paying the dividend did more than half its business within Arizona. Arizona repealed that law in 1990. The refunds would be due for four tax years in the late 1980s. 2 The case is important for the state and its taxpayers for a couple of reasons. Here to talk about that and some of the logistics involved in filing a claim for the refund, is Mark Killian. He is the Director of the Arizona Department of Revenue. Mark, it's good to see you again.

>> Mark Killian: Glad to be here.

>> Michael: This statute goes back quite a ways; right?

>> Mark: It's been on the books many, many years. It was put on the books in 1933. For whatever reason, I guess coming out of the depression, the legislature felt that it needed to give maybe in-state corporations a boost, an incentive for Arizonans to invest in in-state corporations. It was modified in the '70s, but late 1989, '90, the legislature went through the simplification process on taxes, and we did away with schedule A, which this was listed on. As a result of that, we changed the law and it went away.

>> Michael: Held unconstitutional by the State Supreme Court; correct?

>> Mark: That's correct. Well, originally, a case just like this, in 1935 went to the U.S. Supreme Court. It was a South Carolina case. And it was ruled constitutional, that it didn't violate the commerce clause. All of these many years, the state, the department has always felt that it had a strong case in defending this particular statute, but after the legislature repealed this, the lawyers for Mrs. Ladwin came to the Department and wanted refunds, and they wanted us to do a class, cert a class, which we couldn't do and wouldn't do because it had never been done for income taxes. It ended up in the courts. The tax court ruled against us on the merits, and at that time, there was some federal cases that were similar that ruled the same way, so we gave up on the merits of the case, but we didn't give up on the issue of class action. And we appealed that. The appeals court agreed with us and said there shouldn't be class action suits in income tax cases and then last summer, the -- or a year

ago last summer, Arizona Supreme Court basically said, sorry, we're going to have class action lawsuits. The problem with that in that decision, they changed 75 years of juries prudence, administrative tax law and made a huge change in Arizona tax policy.

>> Michael: It clearly ups the ante. The counter argument is that it keeps the State more honest in terms of being absolutely certain that the taxes that it's levying are appropriate, lawful, constitutional. Any counter balancing benefit in that?

>> Mark: No, I don't think so. I think that happens anyway. You can challenge the constitutionality of a tax statute without asserting a class. That's happened before. For whatever reason, for all of those many years, the State, the courts, the law has always been there isn't a class action, but the Supreme Court changed that.

>> Michael: Right.

>> Mark: In effect, what they did is created a huge wealth transfer within the State. That's the argument that people don't talk about too much. All of that money comes out of the general fund, so the average taxpayer is going to help pay back those refunds that typically are going to go to a more wealthier class of taxpayers.

>> Michael: Just because of the passage of time, there is a generational aspect involved in the thing. It goes back 15, 17 years or so to the start of it.

>> Michael: Let's talk about the mechanics of it. This is a massive undertaking, both in terms -- because you are having to reach back into the 1980s, as well as just the scope, breadth of people involved.

>> Mark: This is the biggest project our department has ever had to do. We're trying to find 650 to 700,000 taxpayers. There's many things that complicate that. First of all, over this time people have died so we have to find their estates. People have moved out of the state. We've got to find them. We in Maricopa County have the highest divorce rate of any county in the country. As a result of that, as a complicating factor, we've got to find people who have split their families. We have to contact banks and trusts and companies that handle assets for people to help them find their clients that may be due refunds. This is a huge project. So just the time in getting this done is going to take us time before you're going to see any checks cut by the department and sent out to the taxpayers.

>> Michael: Do you start with the address that was on the 1989 tax return? Is that the most logical starting spot or not?

>> Mark: Well, yes, you do that. We do get some information on from the IRS. We do share information and we can look on their tapes to see what they have. That's where you start. And then you send those notices out. We also put notices in the newspapers, and hopefully people that have moved out of state or have relatives that they think they might have claim to this will contact us, and we will put a notice out through all of the departments of revenue through all of the country where they can link to the Arizona Department of Revenue's Web site so people who want to know if they are eligible can contact us and get information to us.

>> Michael: So, yeah, we've been talking about the department's outreach effort. There is also an ability to tie in either to the Web site or I assume by telephone or whatever, you can give the particulars and get information back about no, you're dad didn't pay this tax or whatever the case might be?

>> Mark: Absolutely, if you've got a question, call the department. Go to a Web site. Tomorrow there'll be a Web site up or a site on our Web site for the Ladwin case. It's got frequently asked questions, people to contact if you've got concerns or questions. That's the other aspect of this that we're trying to do. Even though the department lost this case, the state lost this case, we now are charged with helping the taxpayers get this money back as quickly as we can and the most taxpayer friendly aspect as we can. We spend time trying to figure out how to reach out and help make this as less difficult as we can, particularly in the discussions with plaintiffs and how we tried to structure the settlement. I think we've done it in such a way that it'll make it easier for the taxpayers to get their money back.

>> Michael: We have put a link on our Web site to your Web site.

>> Michael: The timing of it, I mean, obviously, we talked about the logistics. It will take a while to work this out. What is the earliest that the checks actually would be moving on this?

>> Mark: I'm glad you asked that question. It was reported on one of the TV channels last night that the checks will be in the mail in time for Christmas. Not hardly. The soonest we think checks will be going out will be the fall of '04, and again, it's just the massive amount of time it's going to take us to go through all of the records and reconstruct records for people, and find the information, getting some of the old data reconstructed which we're going to have to do. Some of that data is on old degraded microfiche that has to be digitized. The soonest we can get money out the door is the fall of '04.

>> Michael: Is there a function that it would be good to put these checks off a little bit for the state budget?

>> Mark: As we talked to the plaintiff attorneys about when we could pay this out, they were very concerned about the impact on the state budget. And they raised that as an issue. For us, that was a concern, but from a practical standpoint, from an administrative standpoint, we didn't see how we could possibly get money out the door this fiscal year. There'll be some money expended this fiscal year in administrative costs. Again, just the sheer effort to go through and check the records and verify and find all of the information and find the people takes time, and one time -- and at one time during all of the negotiations we thought it may take us an additional 500 people to do all of this work, but that's been pared down, and we think we're going to get done in a reasonable amount of time.

>> Michael: $30 to $40 million in attorneys' fees. Do I understand this correctly?

>> Mark: That's correct.

>> Michael: Is that under advisement by the judge?

>> Mark: The mediator between the state and plaintiff's attorneys has made a recommendation of not more than 12% on the attorneys fees. And that's something that the judge will have to decide whether he wants to accept. In other types of

cases, class action lawsuits, you've seen payouts being as high as 33%. So from a fiduciary standpoint, we think 12% is fair, but we're going to leave it up to the judge to decide whether he wants to lower that or not.

>> Michael: Because that sum, whatever that sum may be, is deducted actually from the corpus of the refund amount, roughly $350 million?

>> Mark: That's correct. The administration and the legal fees come out of that $350 million.

>> Michael: All right. Department of Revenue Director, Mark Killian, thank you very much for the information. Best of luck with the assignment.

Videotape of KAET's Horizon Program

[*Video attached to Court's copy only*]

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File No. 8032-04

October 16, 2002

VIA HAND-DELIVERY

Janet A. Napolitano, Attorney General
Office of the Attorney General
1275 West Washington
Phoenix, AZ 85007

Re: *Estate of Helen Ladewig v. Arizona Department of Revenue*

Dear Attorney General:

This letter supplements my letter of October 9, 2002, to Michael Kempner (which was copied to you) concerning this matter. Recent events dictate that I communicate directly with you as the attorney ultimately responsible for the actions of your office in this case. Enclosed with this letter, please find a videotape of Director Killian's appearance on the Horizon television program, which aired on the local Phoenix PBS Affiliate, KAET, last Wednesday evening. Your client, Mr. Killian, was on the program to discuss this case.

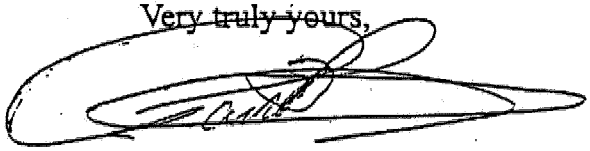
As reflected on the tape, Director Killian, was specifically asked about our fee request and admitted that our request for a 12% fee award in this case is fair: "So from a fiduciary standpoint, we think 12% is fair." In light of your client's unqualified admission, there is no dispute between your client and us pertaining to our pending fee request. As a result, the assertion underlying your pending Motion — that the Department of Revenue needs to review all supplementary evidence including time records and expenses before it can adequately respond to Class Counsel's Motion for a 12% fee award — is false. There is no legitimate reason for your office to contest this issue further. Accordingly, I renew my demand that your office immediately withdraw your Motion before we incur any further time and expense, including additional expert witness fees, in responding to your Motion.

I also caution that if you persist in pursuing your Motion, you will not be able to avoid Rule 11 sanctions by subsequently resorting to the assertion of a hypertechnical justification for the Motion. Given the clarity of your client's admission that 12% represents a fair fee in this case, any such assertion by you would be "unreasonable" under Rule 11. I would refer you to a case you handled, *James, Cooke & Hobson, Inc. v. Lake Havasu Plumbing & Fire Protection*, 177 Ariz. 316, 868 P.2d 329, 333 (App. 1993), for my authority. You are undoubtedly familiar with the law in this area.

Finally, I just learned that the Department has posted your office's frivolous Motion on their website. I do not know if this was intentional or inadvertent. However, we hereby demand that the frivolous Motion be removed from the website immediately. If the Department fails to remove it by 4:00 p.m. tomorrow, we will be required to post this letter, our prior letters to your office concerning the attorney fee and ethical issues, and former Chief Justice Zlaket's report, when finalized, on our website to clarify the record for our clients and inform them of the true facts and correct legal principles applicable in this case. Hopefully, that will not be necessary.

In the enclosed videotaped interview, your client acknowledges the constructive role our firm has played in achieving a settlement. After all the time we spent working on a settlement that benefits everyone — the class members, the Department and the State — I must tell you that I expect more cooperation and professionalism than we are now receiving from your office.

Very truly yours,



Paul V. Bonn

Enclosure
cc: Michael Kempner, Esq. (w/enclosure)
Thomas Prose, Esq. (w/enclosure)
Randall D. Wilkins, Esq. (w/o enclosure)
Eugene O. Duffy, Esq. (w/o enclosure)
D. Michael Hall, Esq. (w/o enclosure)

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October 17, 2002

Paul V. Bonn, Esq.
Bonn & Wilkins, Chartered
805 North Second Street
Phoenix, Arizona 85004

Re: *Estate of Helen Ladewig v. Arizona Department of Revenue*

Dear Mr. Bonn:

We are in receipt of your letters concerning the above referenced matter. We and the Department believe that our motion filed in this case was accurate and appropriate. The Tax Court held a conference with the parties on October 10, 2002 to discuss a procedure to resolve the pending motions. At that conference the Court set a briefing schedule. Once the briefing is complete, the Court should be able to resolve the issues.

Sincerely,

TOM

THOMAS PROSE
Chief Assistant Attorney General

cc: Steve Shiffrin, ADOR